STATE OF CALIFORNIA

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May 4, 2000

TO INTERESTED PARTIES:

REVISION OF ASSESSORS' HANDBOOK SECTION 541
ASSESSMENT OF PUBLIC UTILITIES AND RAILROADS

Enclosed is the first draft of revised Assessors' Handbook Section 541, *Assessment of Public Utilities and Railroads*. Staff solicits comments and proposed changes concerning the draft. The deadline for submitting proposed changes to the draft is June 19, 2000. On July 17, 2000, staff will distribute a second draft incorporating those changes with which staff agrees. At that time staff will also distribute a matrix, or table, showing all proposed changes to the first draft.

On August 22, 2000, staff will hold a meeting with interested parties to review the second draft and all proposed changes. The purpose of the meeting is to reach as much agreement among interested parties as possible about the final language in the manual. The meeting is scheduled from 9:30 a.m. to 2:30 p.m. in Room 122, Board of Equalization, 450 N Street, Sacramento.

If significant differences remain following the August 22 meeting, they will be brought to the Property Tax Committee at its meeting on November 1, 2000. The deadline for interested parties to submit material concerning open issues for inclusion in staff's issue papers—the format in which such matters are addressed by the Committee—is September 29, 2000. Completed issue papers should be available for review by October 20, 2000.

Please submit written comments or suggestions about the project to Paul Lane, Property Taxes Department, Policy, Planning, and Standards Division. If you have questions, contact either Paul Lane at (916) 324-5828 (plane@boe.ca.gov) or Benjamin Tang at (916) 324-2720 (btang@boe.ca.gov).

Sincerely,

/s/ Richard C. Johnson

Richard C. Johnson
Deputy Director
Property Taxes Department

RCJ:pl
Enclosure

ASSESSORS' HANDBOOK
SECTION 541

ASSESSMENT OF PUBLIC UTILITIES AND RAILROADS

DRAFT OF REVISED MANUAL

APRIL 2000

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NOTE TO READERS

Assessors' Handbook Section 541, *Assessment of Public Utilities and Railroads*, describes the principles and procedures used by the Board in the assessment of state-assessed property. The manual is designed to assist Board staff, state assessees and their representatives, county assessors and their staffs, and other interested parties. This is the first draft in a revision of the existing manual, which was first approved by the Board in May 1981.

Subjects covered include central assessment jurisdiction in California, standard of value, principle of unit valuation, property classification, unitary value indicators, inter- and intrastate allocation of unitary value, and appeals of state assessments.

Pending legislation (AB 2891, SB 2170) may change many of the dates cited in the draft (i.e., filing dates, notice dates, etc.). If the law changes, the draft will be revised accordingly.

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CHAPTER 1: STATE ASSESSMENT JURISDICTION

HISTORICAL BACKGROUND

Under the California Constitution of 1849, the state's first, the property tax was the primary source of revenue for both state and local government. Local assessors were responsible for the assessment of all taxable property; the state had no assessment responsibilities. To support its operations, however, the state levied a separate state tax on the locally generated assessment rolls.

Under the Constitution of 1879, the Board of Equalization assumed responsibility for the centralized assessment of the roadway, roadbed, rails, rolling stock, and franchises of intercounty railroads, marking the beginning of state assessment in California. The Board's assessments were apportioned to the local assessment rolls; all other property remained subject to assessment by the local assessor in which the property was situated. There was no change in the way taxes were levied by the state and local jurisdictions—both continued to levy a tax against the local assessment rolls.[1]

Under a constitutional amendment of 1910, implemented through the Comprehensive Tax Act of 1911, the state, and hence the Board, took a leave of absence from the assessment function for roughly a quarter of a century. The primary feature of this legislation was to separate the sources of state and local tax revenues. State government was supported by a new set of taxes levied exclusively for state purposes in lieu of property taxes. The in-lieu taxes reached a number of industries and were levied as follows:

1. On gross receipts from operations of railroad companies, gas and electric companies, telephone and telegraph companies, car companies and express companies, in lieu of all other taxes and licenses on the operating property of such companies.

2. On gross premiums of insurance companies in lieu of all other taxes and licenses, except local taxes on real property.

3. On capital stock of banks in lieu of all other taxes and licenses on such stock and on the banks except local taxes on real property.

4. On all franchises, general, corporate and special, except franchises held by public utilities, insurance companies, or banks otherwise taxed for state purposes.

[1] Under the Constitution of 1879, only railroad property was subject to state assessment, and only enumerated types of railroad property.

While the Board was charged with assessing the foregoing companies for the in lieu tax levies, all other property remained locally assessed and subject to ad valorem property taxation for the support of local government.

In 1933, a state fiscal crisis led to a constitutional amendment producing significant tax reform. The resulting Riley-Stewart Plan for tax relief, perhaps best known for introducing the sales and use tax to California, abandoned the in-lieu gross receipts tax and once again made the property of "public utilities" subject to ad valorem taxation. The plan retained the feature of central assessment by the Board introduced in the Constitution of 1879, and extended the Board's assessment jurisdiction to a broader class of "public utilities" and to all of the taxable property of certain types of enterprises. As previously, state assessments were allocated to the local assessment rolls for the purpose of local property taxation, but now no state tax was levied on the local rolls. The current jurisdiction of state assessment, described in greater detail below, essentially derives from the constitutional amendment of 1933, as does the state's present tax structure, in which non-property tax sources support state government (primarily the sales and use tax and the income tax) and property taxes support local jurisdictions.

CONSTITUTIONAL PROVISIONS

Section 19 of Article XIII of the California Constitution requires the Board to annually assess certain described types of property. The first paragraph of section 19 divides this property into two categories:

> The Board shall annually assess (1) pipelines, flumes, canals, ditches, and aqueducts lying within 2 or more counties and (2) property, except franchises, owned or used by regulated railway, telegraph, or telephone companies, car companies operating on railways in the State, and companies transmitting or selling gas or electricity. This property shall be subject to taxation to the same extent and in the same manner as other property.

The first category of property consists of specific types of improvements, that is, pipelines, flumes, canals, ditches, and aqueducts lying within two or more counties. The important qualification with regard to this category is that the properties are located "within two or more counties," without regard to the nature of the property owner. For example, if an oil company owns a pipeline lying within two or more counties, the Board is required to assess the pipeline but not other property owned by the oil company.

The second category of property consists of all taxable property, excluding franchises, owned or used by regulated railway, telegraph, or telephone companies; car companies operating on railways in the state; and companies transmitting or selling gas or electricity. Rather than being based on the type of property to be assessed, this category includes *all* of the property that is owned or used by specified types of companies. Under this category, all of the property owned or used by a specified company is subject to the Board's assessment. For example, Southern Pacific Railroad was at one time the largest private property owner in the state. For historical reasons, it

owned large tracts of land in addition to the property owned or used for railroad purposes. Under section 19 the Board is required to assess all of its property, including the tracts of land not actually used for railroad purposes.

The provisions of the Revenue and Taxation Code implementing section 19 of article XIII are found in sections 721 and following.[2] Section 721 states that the Board shall annually value and assess all of the taxable property within the state that is to be assessed by it pursuant to section 19 of the California Constitution and any legislative authorization thereunder. Section 721, however, does not provide any definition or detail regarding the type of property to be assessed beyond that listed in section 19 of article XIII.[3]

Several historical reasons led to central assessment by the Board most of which derived from perceived problems associated with the assessment of railroad property during the 1870's, shortly after California's statehood. These issues mirrored those in several eastern and Midwestern states that arose slightly earlier.

First, early railroads were the first entities to operate across county, and often state, boundaries. The "continuous property" of railroads (e.g., roadway, roadbed, and rails) was assessed markedly differently in among counties. This created a significant problem related to intercounty uniformity and equalization of assessment, a mandate of the state's first constitution. Centralized assessment was also considered the most efficient assessment solution for "migratory properties," such as private railroad cars, because of the difficulty of determining the location, or situs, of such properties on the lien date.

A second consideration involved doubts regarding the ability of local assessors to render equitable assessments given the political power of the early railroads. In this context, state assessment represented a countervailing power.

Finally, there was a concern that the "true value" of railroad property as part of an operating unit, or going concern, was not being reflected in the separate assessments of the local assessors.

[2] All references to "section" refer to a section of the California Revenue and Taxation Code, unless otherwise designated. All references to "rule" refer to a rule in Title 18, California Code of Regulations, unless otherwise designated.

[3] Some assessment statistics put state assessment in perspective. For 1999-2000, the value of all property assessed in California—by the 58 county assessors and the Board—was about $2,244 billion. The value of property assessed by the Board was about $69 billion. Thus, state assessments constitute about 3 percent of all property assessments in the state.

There are roughly 690 state assessees. State assessments, however, are highly concentrated. The 8 largest state assessees, for example, received property assessments of about $57 billion, roughly 85% of the $69 billion total of state assessments. (Board data.)

SOME JURISDICTIONAL PRINCIPLES

Over the years, there have been numerous interpretations of the language in section 19 of article XIII, by the Board itself and others, relating to the Board's assessment jurisdiction. This section discusses some of the principles that have emerged and how they have been applied.

First, as a quasi-judicial, constitutional body, the Board has the right to determine its own jurisdiction in the first instance. In essence, this means that the Board has the right to pass on its own jurisdiction first, and that this determination will stand unless overruled by a higher legal authority. This power stems from other powers conferred on the Board in sections 11, 17, 18, and 19 of article XIII that are quasi-judicial in nature and on the Board's status as an agency of constitutional origin.

Second, the Board's assessment jurisdiction over property owned by various types of common carrier (i.e., transportation) and public utility companies extends both to those that are "regulated" and those that are "unregulated." For example, paragraph (2) of section 19 of article XIII grants the Board jurisdiction to assess property "owned or used by regulated railway, telegraph, or telephone companies, car companies operating on railways in the State, and companies transmitting or selling gas or electricity." In this passage, the adjective "regulated" does not grammatically modify "car companies" or "companies transmitting gas or electricity"; thus the Board's jurisdiction extends to car companies and companies transmitting or selling gas or electricity whether or not such companies are regulated.

The majority of companies whose property the Board has historically assessed have been regulated in the sense that they hold certificates of public convenience and necessity (CPCN) from the California Public Utilities Commission (CPUC), or in the sense that many communications companies are regulated by the Common Carrier Bureau of the Federal Communications Commission (FCC).

Until recent years, many companies subject to state assessment were also rate-regulated, meaning that in exchange for certain monopoly rights over a designated franchise or service area, the companies were limited in the rates they could charge. Other companies were, and some still are, rate-base/rate-of-return regulated, meaning that the rates, or income, that regulators allow such companies to earn are designed to cover costs, including taxes and depreciation, and also provide a "fair" rate of return on investment, often as measured by a fair rate of return on rate base. Rate base, with some modifications, is essentially the book, or accounting, value of the company's assets used in providing service. With the deregulation of several industries in recent years, however, the majority of state assessees are no longer subject to rate regulation or rate-base/rate-of-return regulation.

Third, while the Board historically has assumed jurisdiction of all investor-owned "public utilities," some state assessees are not public utilities in the common meaning of that term. A definition of "public utilities" from section 3, article III, of the California Constitution provides, in part:

> [P]rivate corporations and persons that own, operate, control, or manage a line, plant, or system for … the production, generation, transmission, or furnishing of heat, light, ... power, … directly or indirectly to or for the public… are public utilities subject to control by the Legislature.

Some of the types of state assessees enumerated in section 19 of article XIII are within the above definition of investor-owned public utilities and some are not. For example, many companies that own pipelines, canals, or aqueducts are not public utilities by this definition. Consequently, the Board does not rely on a definition of "public utilities" as the touchstone of its jurisdiction. Rather, the Board has consistently assessed only those types of property and the property of those types of companies enumerated under section 19 of article XIII, whether or not the companies are "regulated" or meet the definition of a "public utility." The Board's determination of jurisdiction does not rest on the outward appearances of a property or company, but rather on whether the Board concludes that section 19 of article XIII provides the Board with jurisdiction to assess. A recent example of the Board determining both the extent and limits of its jurisdiction under section 19 of article XIII occurred as a result of the restructuring of the electric industry, which is discussed in further detail below under that specific area of the Board's jurisdiction.

SPECIFIC AREAS OF BOARD JURISDICTION

RAILROADS AND PRIVATE RAILROAD CARS

The property of "regulated railways" is specifically enumerated in section 19 of article XIII as subject to state assessment. All railways are regulated in that they are subject to safety and common carrier regulation by the United States Department of Transportation. The Board holds assessment jurisdiction over all railways, including so-called "shortline railroads"—those that own track and are located within only one county.[4]

The property of "car companies operating on railways in the State" is also specifically enumerated in section 19 of article XIII. The Private Railroad Car Tax, at sections 11201 and following, prescribes a specific method for the assessment of this type of property. As unambiguously defined in section 11203, a "private railroad car"

> includes any railroad rolling stock intended for the transportation of any persons, commodity, or material, operated on the railroads of this state, which car is owned by a person other than a railroad or the National Railroad Passenger Corporation.

In addition to assessing private railroad cars, the Board also levies and collects the corresponding tax, which is deposited in the state's General Fund.[5]

[4] In a transportation-industry context, a "common carrier can be defined very generally as an entity engaged in transporting persons, goods, or messages for the public over a regular route, according to specified schedule, and for an approved charge or fee, all of which are usually subject to government regulation. Common carriers are deemed to be "affected with the public interest" and are regulated by the U.S. Department of Transportation.

[5] Appendix A describes the Private Railroad Car Tax in more detail.

INTERCOUNTY PIPELINES

As previously discussed, intercounty pipelines are subject to Board assessment because of the type of property they are and because they are located within two or more counties, not because of the nature of their ownership.

In *Southern Pacific Pipe Lines, Inc.* v. *State Board of Equalization* (1993), the court held that the Board could not assess three pipeline facilities because the facilities were not essential and necessary to the operation of intercounty pipelines.[6] The court held that the term "pipelines" in section 19 referred to the pipelines only, not to the underlying land or rights-of-way or to adjacent lands and improvements. This holding was later codified in sections 401.10 and following. Each county assessor, therefore, has jurisdiction to locally assess *all lands and rights-of-way* in his or her county over or through which pipelines cross. The decision in *Southern Pacific Pipe Lines, Inc.*, however, did not address the other types of property enumerated in paragraph (1) of section 19 of article XIII—that is, flumes, canals, ditches and aqueducts lying within two or more counties—in this context.

TELEPHONE COMPANIES

Section 19 of article XIII mandates Board assessment jurisdiction concerning "property, except franchises, owned or used by regulated … telephone companies.…" The term "regulated telephone company," however, is not defined by the California Constitution, statutory provisions, or the courts in the context of assessment jurisdiction.

As with other state assessees, the Board has interpreted section 19 of article XIII as requiring Board jurisdiction of only telephone companies regulated as public utilities by the California Public Utilities Commission (CPUC) or by a comparable federal commission or board—for example, the Common Carrier Bureau of the Federal Communications Commission (FCC). The Board has treated as "public utilities" telephone companies that have been granted a certificate of public convenience and necessity from the CPUC or that have been classified as communications common carriers by the Common Carrier Bureau under federal law.[7] The Board's practice has been to assess the property of only those telephone companies that are regulated public utilities under either state or federal law.

Long distance resellers and alternative operator services doing business in this state are generally regulated by the CPUC; if they own or lease property in California, the property is subject to Board assessment (e.g., some resellers have their own switching systems in California). If they do not own or lease facilities in California, however, they are not required to file a property statement and the Board has no assessment jurisdiction over them.[8]

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[6] 14 Cal.App.4th 42.

[7] See 29 Ops.Cal.Atty.Gen. 77; and 47 U.S.C.A. 201 and following.

[8] Long distance resellers and alternative operator companies obtain a CPCN to offer telecommunication services over the facilities of the local exchange carrier. The certificate grants resellers and alternative operator companies the right to do business with a local exchange carrier at a discounted rate, which frequently enables them to offer less expensive long-distance service. The CPUC grants certificates to such companies because the public interest is

Some telephone companies and resellers now use satellite transmission that replaces existing wire, fiber, and cellular systems. The FCC is the only regulatory agency that issues permits (i.e., licenses) for the operation of such companies; the CPUC has no regulatory authority. To the extent that the companies own property in California, they are under the Board's assessment jurisdiction, consistent with the Board's position that telephone companies are "regulated" if their permits or operating rights are prescribed by either state or federal law.

Also, some companies formerly operated for other purposes may begin telephone service and thereby become subject to Board jurisdiction. For example, if a cable television company decides to offer telephone services, and obtains authorization under state or federal law for this purpose, all of the company's property then would be subject to the Board's assessment jurisdiction—the company would meet the definition of a "regulated" telephone company.

Occasionally, in such a scenario, the telephone and the cable television operations might be conducted by separate corporations or other legal entities. When companies subject to the Board's assessment jurisdiction form new subsidiary companies, wholly owned either directly or indirectly by the parent company, the "separate legal entity" concept controls whether the Board's assessment jurisdiction extends to the newly created entity. For example, if the newly created entity is the subsidiary of a telephone company, but never obtains either a certificate of public convenience and necessity from the CPUC, or becomes subject to regulation by the FCC as a communications common carrier, then it will not come under the Board's assessment jurisdiction. However, if it operates under the parent company's certificate or common carrier status (or if it acquires either one on its own), it is considered a "regulated" telephone company and will become subject to the Board's jurisdiction.

INTEREXCHANGE AND COMMERCIAL MOBILE RADIO SERVICE

Similarly interexchange and commercial mobile radio service companies are subject to the Board's assessment jurisdiction only if they can be classified as "regulated telephone companies" pursuant to section 19 of article XIII.[9]

The FCC allocates radio frequencies, or channels, to both public and private radio carriers. Prior to 1995 legislation and the FCC's resulting deregulation in 1996, the CPUC classified all public radio carriers (i.e., those authorized to provide service to the general public) as regulated radio telephone utilities, and required a CPCN for their operations. In 1995, subdivision (b)(2) of section 234 of the Public Utilities Code was amended to exclude "any one-way paging service

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served by promoting effective competition among telecommunications service suppliers. Whether or not resellers actually lease or purchase the use of a switch or any of the facilities of the local exchange carrier is a matter of agreement between the companies involved in each case.

[9] A "commercial mobile service" is "any mobile service ... that is provided for profit and makes interconnected communication service available (a) to the public or (a) to such classes of eligible users as to be effectively available to a substantial portion of the public, as specified by regulation by the Commission." A "private mobile service" is "any mobile service that is the functional equivalent of a commercial mobile service, as specified by regulation by the Commission." An "interconnected service" is a "service that is interconnected with the public switched network (as such terms are defined by regulation by the Commission) or service for which a request for interconnection is pending." (47 U.S.C.A. §332, subdivision (d).)

facilities that are licensed by the Federal Communications Commission" from CPUC regulation.[10] Two-way paging companies were specifically excepted from the amending legislation and the amended statute. Based on this change in state law, the Board determined that for the 1996 lien date and thereafter one-way paging companies and narrow-band personal communications services that are not otherwise subject to Board jurisdiction will be assessed by county assessors because, statutorily, these companies are not "telephone companies."

Similarly, the Board has concluded that property used in the satellite transmission of voice communications should be excluded from its assessment jurisdiction when the system is used for television broadcast or other one-way transmission. In the Board's view, such systems do not meet the constitutional definition of a regulated telephone company.

GAS AND ELECTRIC COMPANIES

Until recently, property owned by all gas and electric companies was subject to Board assessment. The only significant exception was electric cogeneration plants, which had historically been locally assessed. In 1996, however, legislation restructured the electric industry in California, excepting many companies that were and/or would be generating and selling electricity from rate regulation by the CPUC.[11]

One of the main objectives of restructuring, or "deregulation," was to achieve a more competitive market for electric power by allowing new market entrants to purchase or build electric generation plants and sell electricity to the public. This was accomplished, in part, by requiring existing regulated companies with power generation and distribution facilities to sell power to a Power Exchange, an entity that acts as a market facilitator for the purchase and sale of electric power and that was created by the legislation.

To address the jurisdictional implications of electric industry restructuring, the Board adopted rule 905. Rule 905 limits the Board's assessment jurisdiction in the electric generation segment to property owned by companies in which (1) the electric generation facility was constructed pursuant to a certificate of public convenience and necessity issued by the CPUC, or (2) the company owning the facility is a state assessee for other reasons[12]. As a result of rule 905, there has been a shift from state to local assessment of some electric generation facilities. These facilities were assessed by the Board in 1998 but were subsequently sold to independent power companies that do not come under Board assessment jurisdiction under the provisions of rule 905. About seven investor-owned public utilities (with both power generation and distribution facilities) remain subject to rate-regulation and are still considered "public utilities" by the CPUC. Under rule 905, the property of these companies continues to be assessed by the Board.

Some companies engaged in the transmission of gas are not regulated by the CPUC because they are interstate natural gas pipeline companies that sell and deliver natural gas in interstate commerce. These companies are, nevertheless, considered public utilities in that they deliver

[10] Chapter 357, Statutes of 1995 (AB 202)
[11] Chapter 854, Statutes of 1996 (AB 1890)
[12] "Other reasons," however, excludes state assessment that results from owning an intercounty pipeline.

their product to various locations in California under the exclusive authority and rate regulation of the Federal Energy Regulatory Commission. The Board's assessment jurisdiction also extends to this category of gas company.

BOARD JURISDICTION INCLUDES UNITARY AND NONUNITARY PROPERTY

An important statutory distinction made in regard to property types assessed by the Board is that found in 723 and 723.1, the distinction between unitary and nonunitary property. Unitary property is property used in the primary function of an assessee; nonunitary property is property owned by the assessee but not used in the assessee's primary function. The distinction between unitary and nonunitary is discussed in more detail in a later chapter. For the purpose here, suffice it to say that Section 19 of article XIII requires the Board to assess property that is "owned or used" by a state assessee. This means that both the unitary and nonunitary property of a state assessee is subject to Board assessment. For example, a campground owned by a gas company, even though it is not used in the company's utility operations, would still be assessed by the Board as the assessee's nonunitary property.

STATE ASSESSMENT PROCESS

To provide an overview of the general process of state assessment, several major steps in the process are described in roughly chronological order below. These steps also point to the subject matter discussed in subsequent chapters.[13]

1. The assessee files a property statement as required by section 826. Property statements must be filed no later than March 1 of each year; but the Board *may* grant limited extensions for specified parts of the property statement under section 830.1.

   The Board prescribes several variations of the property statement, depending on the type of property reported or the industry of the assessee. In general, however, the variations share the following common elements: (1) a declaration of costs and other related property information; (2) a tangible property list; (3) summary control accounts; (4) a statement of land changes and land identification maps; (5) schedules of leased equipment; and (6) other requested information.

2. The Valuation Division, a unit of the Board's Property Taxes Department, develops unitary valuation indicators and makes recommendations to the Board regarding the value of the assessee's unitary property. State assessees are afforded an opportunity to discuss the value of their unitary property at a public Board meeting held in May.

3. The Board determines the value of the assessee's unitary and nonunitary property. Unitary value determinations are made and publicly announced no later than May 31. Nonunitary value determinations are made and announced no later than the last day of June. (Chapter 4 discusses value indicators.)

[13] Appendix D is a calendar of important dates in the annual state assessment cycle.

4. If a state assessee operates in more that one state, a portion of the value of the assessee's unitary property is allocated by the Board to California (interstate allocation). The portion of the value of the assessee's unitary property allocated to California—or, the total value of the assessee's unitary property if the assessee's operations are only in California—is allocated by the Board among the counties in which the property is located (intrastate allocation). (Chapter 5 discusses value allocation.)

5. The state assessee is given an opportunity to petition the Board for review of and to appeal the assessed value and claim a refund. (Chapter 6 discusses the appeals process for state assessments.)

CHAPTER 2: STANDARD OF VALUE

In any appraisal, there are two primary conceptual issues that must first be addressed: (1) the standard of value, or value concept, that is being sought and (2) the unit of property that is being valued. This chapter discusses the first of these conceptual issues; the following chapter discusses the second.

MARKET VALUE STANDARD

Section 1 of Article XIII of the California Constitution states

> Unless otherwise provided by this Constitution or the laws of the United States.
> (a) All property is taxable and shall be assessed at the same percentage of fair market value. When a value standard other than fair market value is prescribed by this Constitution or by statute authorized by this Constitution, the same percentage shall be applied to determine the assessed value. The value to which the percentage is applied, whether it be the fair market value or not, shall be known for property tax purposes as the full value.
> (b) All property so assessed shall be taxed in proportion to its full value.

Thus, the standard of value, or value concept, by which all state-assessed property is assessed is "fair market value".[14] With the exception of restricted value property, whose value is statutorily prescribed at a standard other than market value as recognized in the second sentence of subdivision (a) above, this is the same value standard applied to locally assessed property.[15]

Section 110 describes the concept of market value. As provided in subdivision (a):

> Except as is otherwise provided in Section 110.1, "full cash value" or "fair market value" means the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other and both the buyer and the seller have knowledge of all the uses and purposes to which the property is adapted and for which it is capable of being used and of the enforceable restrictions upon those uses and purposes.

Salient elements of the above definition include the following:

[14] Prior to 1981, property was assessed at a percentage of fair market value; this percentage was called the assessment ratio. Since 1981, property has been assessed at 100 percent of fair market value, an assessment ratio of 1.0.

[15] Several terms are used synonymously with "fair market value" in property tax statutes and regulations. These include "full cash value," "cash value," "actual value," and "market value."

- Market value is measured in the “amount of cash or its equivalent.” This means that the sale price of the subject property or sales prices of comparable properties used as evidence of market value should be stated in terms of cash.

- The property is “exposed for sale in the open market.” This means that all potential buyers have sufficient of time or analyze and bid on the property

- Neither buyer nor seller “could take advantage of the exigencies of the other.” This renders buyer and seller as hypothetical persons dealing with each other at arm’s length—that is, neither is influenced by special motivations or particular circumstances.

- Buyer and seller “have knowledge of all the uses and purposes to which the property is adapted.” The value of property depends on its use. This passage means that buyer and seller are aware of the highest and best use of the property, which is the lawful use that maximizes the property’s value, and consider the value of the property in light of such use. In other words, buyer and seller are prudent, rational economic beings.

Subdivision (b) of section 110 establishes a rebuttable presumption that "full cash value" or "fair market value," as defined in subdivision (a), is the actual purchase price if the terms were negotiated under specified conditions reflecting an "open market transaction." Under subdivision (c), this rebuttable presumption does not apply when a taxpayer has failed to provide certain information about the conditions of the transaction.

Subdivisions (d), (e), and (f) of section 110 express the concept that intangible assets and rights relating to the operations of a business may not enhance the value of taxable property. While intangible assets and rights are not themselves taxable, property that is otherwise taxable may be valued by assuming the presence of intangible assets or rights necessary to put the property to beneficial or productive use. As will be discussed in greater detail later, these subdivisions are particularly pertinent to the state assessment.[16]

In any given market, the variables that determine supply and demand, and hence market value, are subject to change, sometimes rapid change. An important consideration regarding market value, therefore, is that it is something that exists as of a given point in time. It is, therefore, necessary to specify a date of valuation in any consideration of market value. Accordingly, section 722 specifies that state-assessed property is valued as of 12:01 a.m. on January 1, the lien date for property tax purposes.

[16] For additional discussion of the market value concept, see Assessors’ Handbook Section 501, *Basic Appraisal*, and Assessors’ Handbook Section 502, *Advanced Appraisal*.

STATE-ASSESSED PROPERTY AND ARTICLE XIII A OF THE CALIFORNIA CONSTITUTION[17]

In June 1978 California voters passed an initiative constitutional amendment that significantly restructured California's property tax system. Proposition 13, which added article XIII A to the California Constitution, contained four primary elements: (1) a limit on the ad valorem property tax rate to 1 percent of the assessed value (except in the case of pre-existing bonded indebtedness or subsequent bonded indebtedness approved by a two-thirds vote); (2) a rollback of assessed values to their 1975-76 levels; (3) a limit on the annual growth in assessed value to a maximum of 2 percent per year, in the absence of a change in ownership or new construction; and (4) reassessment at current market value only upon a change in ownership or new construction.

In *ITT World Communications, Inc.* v. *City and County of San Francisco*, the California Supreme Court ruled that article XIII A's assessment rollback, its 2 percent limit on annual assessment growth, and its limit on current market value assessment only upon a change in ownership and new construction did not apply to state-assessed property, only to locally assessed property.[18] As a result, taxable property in California is now generally split into two major categories: locally assessed property subject to the property tax limitations of article XIII A and state-assessed property not subject to article XIII A.

In reaching its decision, the court presented the following major arguments. First, it held that article XIII A, by its own terms, was limited to real property taxation, but that the "unit taxation" of state assessed property was not real property assessment in substance or form. Second, it held that because article XIII A used the phrase "county assessor's valuation," again, by its own terms, the article applied only to locally assessed property. Third, and finally, the court held that the phrase "subject to taxation to the same extent and in the same manner as other property" from section 1 of article XIII of the California Constitution did not impose a requirement of valuation on the same basis between public utility and other property, but simply specified that state and local assessments must be levied on at the same tax rate.

RAILROAD REVITALIZATION AND REGULATORY REFORM ACT

Congress enacted the Federal Railroad Revitalization and Regulation Reform Act (4-R Act) in 1976. The general purpose of the Act, as stated in section 801 of Title 45 of the United States Code, is

> [t]o provide the means to rehabilitate and maintain the physical facilities, improve the operations and structure, and restore the financial stability of the railway system of the United States.…

[17] Although not strictly about the "market value standard," this section relating to state-assessed property and article XIII A and the next section relating to the Railroad Revitalization and Regulatory Reform Act are included here because both relate to the method of assessment for state-assessed property.

[18] *ITT World Communications, Inc.* v. *City and County of San Francisco* (1985) 37 Cal.3d 859.

Another objective of the Act is to prohibit states from adopting tax structures that discriminate against railroads. Specifically, section 11501 of Title 49 of the United States Code prohibits the assessment of railroad property at a higher ratio to current market value than the analogous ratio for commercial and industrial property generally.[19]

The 4-R Act itself does not distinguish between the real and personal property of railroads. In *Trailer Train Co.* v. *State Board of Equalization*, however, the court concluded that personal property, specifically private railroad cars, is subject to the same assessment standards and limitations as real property.[20] Thus, the same "effective tax rate" that is applied to commercial and industrial property generally must be applied not only to all railroad property but also to private railroad cars. In this context, effective tax rate means the assessment ratio multiplied by the actual property tax rate.

To comply with the 4-R Act, the Board must ensure that all railroad property and private railroad cars are assessed at the same percentage of (or ratio to) current market value as other commercial and industrial property. For example, if for commercial and industrial property the ratio of assessed value to current market value is 83%, then the current market values of all railroad property and private railroad cars must be multiplied by 83% to arrive at their taxable values.

Board staff calculates the statewide ratio of assessed value to current market value for commercial and industrial property in an annual assessment ratio study. In essence, the sum of the assessed values of locally assessed land, non-fixtures improvements, fixtures, and personalty and the assessed value of all state assessed property is divided by the corresponding sum of their respective estimated current market values.

The resulting percentage is generally less than 100% because locally assessed real property is assessed under the provisions of article XIII A of the California Constitution, which prescribes a base year assessment method that often results in a taxable value lower than current market value.

[19] As defined in *Trailer Train Company* v. *State Board of Equalization* 697 F.2d 860 (1983), commercial and industrial property "means property, other than transportation property and land used primarily for agricultural purposes or timber growing, devoted to a commercial or industrial use and subject to a property tax levy."
[20] *Trailer Train Co.* v. *State Board of Equalization* (1983) 697 F.2d 860

CHAPTER 3: VALUATION USING THE UNIT CONCEPT

APPRAISAL UNIT AND THE PRINCIPLE OF UNIT VALUATION

The second major conceptual problem that must be resolved in any appraisal is a determination of the unit of property to be valued—that is, the property for which a market value estimate is sought. This problem is not limited to the central assessment of public utility property; it appears in every appraisal as the familiar question of the proper appraisal unit. When an appraiser decides on the proper unit of property to be valued, he or she has determined to not add up the values of any smaller units to arrive at the value of the unit.

In the context of the central assessment of public utility property, the problem of appraisal unit has been analyzed using a concept called the "principle of unit valuation." Other terms used synonymously include "unit valuation," "unit method," "unit concept," or "unit approach."

The principle of unit valuation holds, in essence, that a collection of tangible assets functioning as an operating unit should be valued as a whole, without reference to the separate values of the assets constituting the operating unit. A unit valuation is contrasted with a "summation valuation," in which the component parts of an operating unit are valued separately and summed to estimate the value of the whole. The fundamental premise of unit valuation is that a synergistic value is created when individual assets are combined into an operating unit.

Unit valuation has also been described as follows:

> As its starting premise, the [unitary valuation] concept assumes that it is meaningless to consider the value of a mile of track, a substation, or a reel of cable standing apart from the entire operating system. The unit value of the enterprise may be either more or less than the total value of the individual assets making up the whole. Presumably, if each asset were sold separately, the total price received would be substantially less than the value of the enterprise as a going concern. This becomes more apparent when it is considered that ten miles of underground cable has a questionable worth, other than a minimal scrap value, if there is no generating plant at one end to provide electricity and no source at the other end to receive electrical energy. Similarly, fifty miles of railroad track, standing alone, are of questionable utility without the rest of the system.[21]

THEORETICAL BASIS

An examination of the theoretical rationale underlying the determination of the appraisal unit in general also reveals the underpinning for the principle of unit valuation used in the valuation of public utility property.

[21] Louis G. Bertane, *The Assessments of Public Utility Property in California*, 20 UCLA L. Rev. 419.

A market situation contains two primary attributes: a sale price *and* a unit of property that is sold. Given the market value standard of property tax assessment, it is logical and theoretically appropriate to think of the proper appraisal unit as a market unit. Indeed, for most types of property, assuming a relatively active market, the proper appraisal unit, or unit to be valued, is revealed by the market itself. The market provides the benchmark for determining the unit of property to be valued. [22] For example, in the market for single-family homes the unit traded is the land *and* the improvement, the lot *and* the structure. The typical buyer or seller does not ascribe separate values to the lot and the improvement and sum them; they sell together as a market-defined unit. Further,

> [I]t would be meaningless to say that the buyer paid a certain percentage of the total price for the house and the remainder for the lot, just as it would be meaningless to say that the buyer paid a certain amount for the plumbing, a certain amount for the wiring, a certain amount for the foundations and a certain amount for the front door. The point is that the buyer bought the house and lot *as a unit* and there is no logic to any further distinctions. [Emphasis retained.] [23]

In the valuation of public utility property, for which market activity is frequently limited, the appraiser must hypothesize regarding the unit of property that *would* be traded if an active market did exist. One approach is to make the individual items that constitute the entire utility system, for which sales data are readily available, the basic units of valuation. This, as noted, is the summation approach, and the value of the system as a whole would then be summation of the separate market values of these items.

According to the principle of unit valuation, however, this approach would be incorrect. It is incorrect because once the individual items have been combined into a system they have, in effect, been transformed into a different type of property, a type of property in which the individual items constituting the system no longer have separate market values. And,

> In this sense, there is only a difference of degree between a house and a public utility enterprise.… At the time of the purchase of each item the price of the item is equivalent to its market value. But when all of the materials have been combined, it is meaningless to talk about the value of the wood and the value of the electrical fixtures and the value of all the other individual items and then say the value of the whole is equal to the sum of the values of these individual parts.… Each loses its physical identity in the act of installation and a mere desire to [separately] value the property does not restore this identity. There are probably few who would raise serious objections to valuing a house as an entity.… Yet

[22] The market basis of the unit to be valued is noted in subdivision (d) of section 51: "For purposes of this section, 'real property' means that appraisal unit *that persons in the marketplace commonly buy and sell as a unit*, or that is normally valued separately." [Emphasis added.]

[23] California Legislature, 1953 Regular Session, Report of the Senate Interim Committee on State and Local Taxation, Part Six, "Property Assessments and Equalization in California," (Sacramento: California Legislature, 1953) 37. [Hereafter "Senate Interim Committee Report."]

> there does seem to be a certain reluctance to apply the same principles to a large industrial enterprise or a public utility.[24]

The question remains, Why do buyers and sellers of houses think in terms of the whole and not the parts? The answer, which is the theoretical underpinning of the appraisal unit concept, is because of the close functional relationship among the parts constituting the unit:

> *Why* does the buyer [and seller] of a house think in totals rather than fractions? The answer is clearly that the roof has almost no value without the walls that support it, the walls have almost no value without the foundations which support them, and the foundations have almost no value without the land which supports them.… *The individual parts of this house and lot perform cooperative functions.*… [I]t is equally true that the many operating parts of a complex railroad system, telephone company or gas and electric enterprise perform cooperative functions. For the same reason they must be valued as an entity rather than as a collection of pieces. [Emphasis retained.][25]

This single criterion of functional integration, however, is not adequate in and of itself. In a highly integrated and interdependent economy it is difficult to establish absolute functional boundaries. Functional integration must be combined with an obvious characteristic of the market situation—ownership:

> A sale represents a transfer of ownership and in normal circumstances the seller of a piece of property cannot market the property unless he owns it.… [T]he valuation unit may not extend beyond the boundaries of the unit of ownership, if only because the ownership unit determines the maximum unit of marketability and marketability is an essential element in the concept of market value.[26]

Thus, from a theoretical perspective, the principle of unit valuation holds that the unit of property appropriate for the estimation of a market value should include all property items that are *functionally related* and within *common ownership*.

LEGAL BASIS

Several court cases have addressed the unit valuation of public utility property. In *Southern California Telephone Company* v. *Los Angeles County*, the court held that public utility property must be valued "as a whole" in order to ensure the assessment of those values that "cling to the entire property as a unit" and to ensure uniform assessment of public utility property.

> [T]he power to assess public utility property is placed exclusively in the hands of the Board of Equalization as a sole, central assessing agency. This is significant, because it is the common function of central assessing agencies to evaluate such

[24] Senate Interim Committee Report, 38.
[25] Senate Interim Committee Report, 38
[26] Senate Interim Committee Report, 40.

> property as a whole in order to assure the assessment of those values which cling to the entire property as a unit, and in order to assure the assessment of the same type of property at uniform value throughout the state. These are the reasons for central assessment of appellant's property as distinguished from local assessment thereof in all of the fifty-eight different counties.[27]

And in *ITT World Communications, Inc.* v. *City and County of San Francisco* (1985) 37 Cal.3d. 859 (also cited in *GTE Sprint Communications Corp.* v. *County of Alameda* (1994) 26 Cal.App.4th 992):

> One of the primary objectives of the system of unit taxation of public utility property is to ascertain and reach with the taxing power the entire real value of such property. [Citations.] It has long been recognized that "public utility property cannot be regarded as merely land, buildings, and other assets. Rather, its value depends on the interrelation and operation of the entire utility as a unit. Many of the separate assets would be practically valueless without the rest of the system. Ten miles of telephone wire or one specially designed turbine engine would have a questionable value, other than as scrap, without the benefit of the rest of the system as a whole. [Citation.] Unit taxation prevents real but intangible from escaping assessment and taxation by treating public utility property as a whole, undifferentiated into separate assets (land, buildings, vehicles, etc.) or even separate kinds of assets (realty or personalty).

The United States Supreme Court has also consistently upheld the legal validity of unit valuation by central assessing authorities. The method has been challenged by taxpayers on several grounds, including uniformity of taxation in regard to state versus local assessment; assessment of intangible value; burden on interstate commerce; and assessment of extrastate property. Notable cases addressing such matters include the following; *State Railroad Tax Cases* (1875) 92 U.S. 185; *Adams Express Co.* v. *Ohio State Auditor* (1899) 166 U.S. 185; *Cleveland, Cincinnati, Chicago & St. Louis Railway* v. *Backus* (1893) 154 U.S. 439; and *Norfolk & Western Railway* v.*Missouri State Tax Commission* (1968) 390 U.S. 317.

Finally, Section 723 authorizes the Board's use of the principle of unit valuation:

> The board may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in a primary function of the assessee. When so valued, those properties are known as ''unitary property.'' Property of an assessee not valued through the use of the principle of unit valuation are [sic] known as ''nonunitary property.''

[27] *Southern California Telephone Company* v. *Los Angeles County* (1941) 45 Cal. App 2d. 111

ADJUSTMENTS WHEN USING THE PRINCIPLE OF UNIT VALUATION

The next chapter discusses the approaches to value as they are applied in unit valuation. Noted here, however, is that several adjustments may be required to the initial unitary value indicator prior to arriving at the final unitary value indicator and the allocation of the unit value. These adjustments can be divided into two general types. The first type is required to adjust the initial value indicator so that it reflects only the value of the unitary property; the need for and nature of this adjustment depends on the approach to value that is used. The second type is required to adjust the unit value indicator so that it does not contain nontaxable property—either nontaxable tangible property or intangible assets or rights. These adjustments will be discussed in the following chapter in the context of the approaches to value.

CLASSIFICATION OF STATE-ASSESSED PROPERTY

In California, state-assessed property is classified into one of four categories: (1) unitary property, (2) nonunitary property, (3) operating nonunitary property, and (4) nonunitary rail transportation property. Stated slightly differently, unitary property and three types of nonunitary property constitute the classifications. Classification affects the way property is valued and, as explained in Chapter 5, the way property value is allocated.[28]

UNITARY PROPERTY

The general definition of unitary property is property owned or leased by the state assessee and used in its primary operations as part of the state-assessee's integrated system.

More specifically, within the general definition the following types of property are classified as unitary: (1) special-purpose or industry-specific property that is leased by the state assessee; (2) property leased by a state assessee, used in the assessee's primary operations, and assessed to the assessee (including taxable possessory interests); (3) property owned and held for future use in the primary operations of the assessee if there is a documented plan for the property's future use and the property is carried in a future use operating account; and (4) property that is owned and used to protect and support other unitary property—due to locational or physical characteristics or other factors. Under the principle of unit valuation, unitary property is valued as a single unit.

Examples of Unitary Property:

- Land, improvements, and personal property owned or leased by a state assessee and used in its primary operation of transportation of freight by rail; gas or fluids by pipeline, canal or ditch; generation, transmission or distribution of electricity; or transmission of information by cellular, paging, or telephone
- Vacant land that is considered necessary to protect areas utilized in the primary operations of the assessee (e.g., buffer areas required for nuclear power plants or gas storage reservoirs, slide areas near railroad tracks, drainage ditches, etc.)
- Vacant land that is located in landlocked areas totally surrounded by sets of railroad tracks or areas adjacent to rights-of-way that are too narrow to be developed to another use
- Property that the state assessee had acquired for use in its primary operations but now has a secondary use (e.g., areas beneath tower lines which are farmed, used for parking or storage; areas above gas storage reservoirs which are farmed)
- Railroad rights-of-way acquired by congressional grant or franchised by a governmental agency
- Utility and railroad easements for rights-of-way
- Railroad property that is leased to agents of the railroad, who manage the property in a rail transportation use (e.g., intermodal container yards)

[28] Appendix C contains tables showing the Board's classification codes for various types of property.

NONUNITARY PROPERTY

Nonunitary property is property that is owned by a state assessee but not used in the assessee's primary operations. Nonunitary property is valued separately and apart from unitary property (i.e., not valued as part of the unit).

Examples of nonunitary property:

- Property owned by and assessed to a state assessee, but leased to others
- Property owned by a state assessee and not used in its primary operations
- A railroad right of way that has had the track removed or has been abandoned (includes the land under the track that has been severed from the operating portion)
- Property used by others without a formal lease (e.g., encroached upon and used for storage, parking, or growing of trees, vines, or crops)

OPERATING NONUNITARY PROPERTY

Operating nonunitary property is specifically defined in section 723.1:

> Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee. This section does not apply to state-assessed property of regulated railway companies.

Section 723.1 essentially provides discretion to the Board. The Board may classify property as operating nonunitary that others classify as unitary. Operating nonunitary property is valued separately and apart from unitary property (i.e., not valued as part of the unit).

Example of operating nonunitary property:

- State assessee-owned property that is included in its rate base but is classified as nonunitary (e.g., land on which a substation has been removed but it still is carried in the rate base) [But excludes railroad property.]

NONUNITARY RAIL TRANSPORTATION PROPERTY

Nonunitary rail transportation property is property owned by a railroad company that is used in rail transportation operations, but is nonetheless valued separately and apart from unitary property (i.e., not valued as part of the unit).

Examples of nonunitary rail transportation property:

- Railroad property leased to Amtrak, Caltrans, or transit districts

- Railroad property leased to others, whose primary use of the property involves the receipt and/or shipping of products or raw material by rail (e.g., lumber yards, liquid tank car receivers, intermodal container yards, automobile loading-unloading facilities, etc.)
- Railroad property owned by and assessed to a state assessee, but leased to others whose primary operation is that of freight transportation (However, state assessee-owned property leased to others but not used for freight transportation is classified as nonunitary.)
- Railroad land leased at a rent substantially below market (e.g., an accommodation lease), where freight or products are received or shipped frequently
- Station grounds used for passenger parking (e.g., Amtrak, Caltrans, Transit districts, etc.)

CHAPTER 4: UNITARY VALUE INDICATORS

Value indicators are the evidences of market value prepared by the appraiser in support of the final value conclusion. Each year, as prescribed in rule 902, staff develops unitary value indicators that are used by the Board in reaching its unitary value determinations. Staff also recommends annual values for state assessees' other property located in California, that is, nonunitary property, operating nonunitary property, and nonunitary rail transportation property. This chapter sets forth the general principles and procedures followed by the Board in the valuation of the unitary property of state assessees, focusing on the prescribed approaches to value in the context of public utility valuation.

Related specifically to the valuation of unitary property, staff of the Board's Valuation Division has recently developed and published the *Unitary Valuation Methods Book*, a document that describes in nuts-and-bolts fashion the valuation models (i.e., valuation approaches) currently used to prepare unitary value indicators. Although the models contained in the *Unitary Valuation Methods Book* will be discussed in this chapter, the reader is referred to that publication for significantly greater detail concerning them. Since the material concerning general valuation principles and methods contained in *Assessors' Handbook* Section 501, "Basic Appraisal," and Section 502, "Advanced Appraisal," applies generally to the valuation of public utility property, the reader is also referred to those sections of the handbook.

Under rule 3 there are five indicators of market value, or value approaches, one or more of which must be considered in property tax valuation:

1. The price or prices at which the subject property or comparable properties have recently sold (*the comparative sales approach*)

2. The prices at which fractional equity interests in the subject property or comparable properties have recently sold, and the extent to which such prices would have been increased had there been no prior debt claims on the assets *(the stock and debt approach*)

3. The cost of replacing reproducible property with new property of similar utility, or of reproducing the property at its present site and at present price levels, less the extent to which the value has been reduced by depreciation (*the replacement* and *reproduction cost approaches,* respectively)

4. If the income from the property is regulated by law and the regulatory agency uses historical cost or historical cost less depreciation as a rate base, the amount invested in the property or the amount invested less depreciation computed by the method employed by the regulatory agency (*the historical cost approach*)

5. The amount that investors would be willing to pay for the right to receive the income that the property would be expected to yield, with the risks attendant upon its receipt (*the income approach*)

COMPARATIVE SALES APPROACH

In the comparative sales approach, the appraiser selects comparable properties based on their similarity to the property being appraised, compares the selected properties to the subject property, and then adjusts the sales prices of the comparable properties for significant differences between the property being appraised and the comparable properties to arrive at an indicated value for subject property. As a general rule, comparable sales that require fewer and less significant adjustments produce more reliable indicators of value.

Comparisons are also made by dividing comparable sales prices by an observable variable related to value and then applying the resulting ratio to the property being appraised. For example, if a comparable house sells for $200,000, and its size is 2000 square feet, the sale price is $200 per square foot. This ratio (i.e., $200/1 square foot) could then be applied to a property being appraised whose size is also known. Ratios of this type are called "units of comparison" and may be based on many physical or economic variables related to value. In the context of public utility valuation, units of comparison are often based on financial variables.

The primary theoretical basis for the comparative sales approach is the appraisal principle of substitution, that is, the concept that an informed market participant would not pay more for a property than the cost of acquiring a substitute property of equal utility. A related concept from finance and economics is called the "law of one price." This law states that in a competitive market equivalent assets will have the same price because of the force of arbitrage. Any difference in market price between equivalent assets is quickly eliminated as arbitraguers buy and immediately resell the equivalent asset for a profit.

The comparative sales approach is applicable when there is an active market for the type of property being appraised and therefore an adequate amount of reliable comparable sales data. Under Rule 4, the comparative sales approach is preferred when reliable market data are available.

Unfortunately, the comparative sales approach is difficult to apply in the valuation of public utility property for several reasons:

- The limited number sales of either the utility entities themselves or direct sales of assets and the complexities that are typically part of such transactions
- The difficulty of obtaining relevant data from companies when transactions do occur
- The difficulty of establishing comparability among companies

The Board's staff currently develops a comparative sales indicator only when there has been a sale transaction involving the property being appraised. A sale involving a public utility firm is typically an arm's length transaction involving knowledgeable buyers and sellers benefiting from expert analysis. But such transactions are often complex—involving stock acquisitions, corporate mergers, asset purchases, and other features—and may require considerable analysis to arrive at a

valid purchase price for the property being appraised. Nonetheless, properly analyzed, such sales are valid indicators of market value.

ADJUSTMENTS TO COMPARATIVE SALES INDICATOR

Under each value approach, the initial unitary value indicator requires one or more adjustments to arrive at a final unitary value indicator. Adjustments are required to subtract value that should not be included in the final unitary value indicator and to add value that should be included but was not reflected in the initial indicator. Although there is considerable overlap, the adjustments vary somewhat by approach, depending on what value is or is not included in the initial value indicator. The *Unitary Valuation Methods Book* describes these adjustments in detail.

Under the comparative sales approach, the appraiser should consider adjustments to the initial value indicator that include, but are not necessarily limited to, the following:

- Nontaxable property or property assessed elsewhere
- Leased property
- Taxable possessory interests

Nontaxable Property or Property Assessed Elsewhere. The value of property that is exempt from taxation (including intangible assets and rights) or property that is taxed in a different manner—such as the in-lieu fee for licensed motor vehicles—may be included in the initial comparative sales indicator. The value of such property must be excluded from the final comparative sales value indicator.

The initial comparative sales indicator may also contain the value of both unitary and nonunitary property. Nonunitary property may be assessed separately by the Board or the Board may delegate the assessment to a county assessor under certain conditions. To produce a unitary value indicator, the value of any nonunitary property—which could run the gamut a few vacant parcels to several subsidiary corporations—must be excluded in the final value indicator.

The income influence method, the book value method, and the direct appraisal method are the three generally accepted methods for allocating the total value in the indicator between unitary and nonunitary property. Although there are several variations, the income influence method essentially allocates value between the unitary and nonunitary property based an estimate of the proportion of income derived from each type. The book value method simply removes the value of the nonunitary property at its book value, that is, its value as recorded on the company's financial statements. The direct appraisal method values each item of nonunitary property separately and then removes the total from the indicator.

Leased Property. Public utility firms acquire the use of property through leases for a variety of reasons, and the value of leased property may be significant. The value of leased property may be estimated by calculating the present value of the remaining payments under the lease. Alternatively, the depreciated cost of the leased asset can be used to estimate its value.

Leases are generally one of two types: capitalized leases and noncapitalized leases. A capital lease is a long-term, noncancelable lease that is, in effect, an installment purchase of assets. The risks of ownership are largely transferred to the lessee. Under generally accepted accounting principles, a capital lease is reflected on the balance sheet as an asset with a corresponding liability typically equal to the present value of the remaining payments under the lease.

A noncapitalized, or operating, lease is a shorter-term cancelable lease often used in equipment rental and servicing agreements. The risks of ownership remain largely with the lessor. Under generally accepted accounting principles, an operating lease is recorded in the manner of an operating expense—the leased property does not appear on the balance sheet.

Unless locally assessed, the value of property under both capitalized and noncapitalized lease agreements, as adjusted, should be included in the final comparative sales approach indicator.[29]

Taxable Possessory Interests. In general terms, a taxable possessory interest is the right to use government-owned property for private benefit. A taxable possessory interest is a taxable interest in real property. As with leases, the value of any taxable possessory interests should be included in the final comparative sales unitary indicator.

[29] In general, if a capitalized lease is assumed by the purchaser, the adjustment to the sales indicator would be to add the liability assumed to the purchase price. For an operating lease, the amount of the adjustment is the market value of the leased property.

STOCK AND DEBT APPROACH

The stock and debt approach is based on the fundamental accounting equation that assets equal liabilities plus owner's equity, but substitutes market values for accounting values. The idea is straightforward: the market values of the firm's total liabilities and owner's equity are estimated and then added together to form an estimate of the market value of the firm's assets. If the firm is publicly traded, current prices of its securities as traded in the capital market can be used to value the liabilities and owner's equity. In essence, the firm's assets are valued indirectly through the capital market by valuing the financial claims against them.

As a simple example, consider a firm with 1,000,000 shares of common stock outstanding at a current market price of $50 per share. The firm also has 100,000 bonds outstanding with a current market value of $750 per bond. Other liabilities total $5,000,000; market value estimates of these liabilities were taken directly from the balance sheet because their accounting values approximated market values. The estimated current market value of all of the firm's assets is the sum of these values, or $130,000,000.

Security	Shares/Bonds		Market Price		Total
Common stock	1,000,000	x	$50/share	=	50,000,000
Bonds	100,000	x	$750/bond	=	75,000,000
Other Liabilities				=	5,000,000
Total (Value of Assets)					130,000,000

Obviously, in a more realistic example, there might be several bond issues, different classes of common stock, preferred stock, and several types of other current liabilities. This would complicate the valuation of the liabilities and owner's equity but would not change the principle—capital market prices are used to value the claims against a firm's assets and thereby value the assets themselves.

EFFICIENT MARKETS HYPOTHESIS

The stock and debt approach depends on the assumption that capital markets accurately value financial claims, that is, that capital market prices reflect the intrinsic economic values of the securities traded. Support for this assumption is found in the efficient markets hypothesis (EMH), one of the most important concepts in finance.

In the context of the EMH, market efficiency refers to informational efficiency, the efficiency with which a market processes information, and not to operational efficiency, for example, how quickly and accurately a market processes trades. An efficient market in an informational sense is a market in which the price of a security or other asset traded instantaneously reflects all publicly available information regarding the security and its future prospects.

The basis of market efficiency is the group of intelligent and well-informed financial analysts constantly on the lookout for mispriced securities. Paradoxically, this dedication to the pursuit of

mispriced securities by a cadre of professional analysts essentially makes it impossible to consistently find mispriced securities, according to the theory.

Whether U.S. capital markets are efficient has been, and continues to be, the subject of much research and debate. There is considerable research evidence, however, demonstrating that U.S. capital markets are highly efficient and, therefore, that prices in U.S. capital markets can be trusted to represent fair market values.[30]

COMPLICATIONS

Although straightforward in concept, in practice the stock and debt approach involves several complications. Notable are the limited applicability of the approach and the issue of control premiums.

An obvious limitation of the stock and debt approach is that it cannot be applied to value the property of a firm whose common stock is not publicly traded or is thinly traded. This limitation is not as severe, however, with non-traded or thinly traded debt issues or with preferred stock. Since these types of securities typically provide fixed payouts, the appraiser can value them by discounting the future promised payments at the yield rate prevailing on traded securities of equivalent risk.

The stock and debt indicator is based on sales prices of minority interests and does not reflect any "control premium" that may exist. There are many reasons why a buyer might offer a premium to existing shareholders to acquire a controlling interest, but, economically, they all boil down to this: The buyer thinks the cash flow and resulting value of the firm's assets can be increased if the firm is under the buyer's control. In the absence of a visible takeover bid, however, determining that a control premium exists and estimating its amount are skills more in the realm of investment banking and mergers and acquisitions analysis than appraisal. Few appraisers are experts in the market for corporate control.

ADJUSTMENTS TO STOCK AND DEBT INDICATOR

Under the stock and debt approach, the appraiser should consider adjustments to the initial value indicator that include, but are not necessarily limited to, the following:

- Nontaxable property and property assessed elsewhere
- Leased property
- Taxable possessory interests

Nontaxable Property and Property Assessed Elsewhere. The value of property that is exempt from taxation (including the value of intangible assets and rights) or the value of property that is

[30] Most finance or investment texts contain discussions of the EMH and related research. For example, see William F. Sharpe, Gordon J. Alexander, and Jeffery V. Bailey, *Investments*, sixth edition (Upper Saddle River, New Jersey: Prentice Hall, 1999).

taxed in a different manner may be included in the initial stock and debt indicator. The value of such property must be excluded from the final stock and debt value indicator.

The initial value indicator in the stock and debt approach also often contains the value of both unitary and nonunitary property. Nonunitary property may be assessed separately by the Board or the Board may delegate the assessment to a county assessor under certain conditions. The value of any nonunitary property must be excluded from the final value indicator. The methods for removing the value of nonunitary property from an initial indicator were briefly described in the preceding section—that is, the income influence method, the book value method, and the direct appraisal method.

Leased Property. As described earlier, leases are generally one of two types: capitalized leases and noncapitalized leases. The value of property under a capitalized lease should already be reflected in the initial stock and debt indicator because such leases appear on the balance sheet. If not locally assessed, the value of property under noncapitalized, or operating, leases should also be included in the final stock and debt indicator.

Taxable Possessory Interests. As described, in general terms, a taxable possessory interest is the right to use government-owned property for private benefit. A taxable possessory interest may not appear on the firm's balance sheet, and its value should be included the final stock and debt indicator.

REPRODUCTION AND REPLACEMENT COST APPROACHES

In general, the cost approach may be used when the current cost of replacing a property provides evidence of the property's value. The rationale for the use of the cost approach is based on the economic principle of substitution. This principle holds that a rational person will pay no more for a property than the cost of acquiring a satisfactory substitute, assuming no costly delay. The condition of no costly delay must be satisfied, or the cost of the delay must be added to the cost of a substitute property. If it would not be worthwhile to replace the property (i.e., if the delay in acquiring a substitute is too costly) then the cost of replacement cannot be said to represent the property's market value.

The cost approach is most reliable when the property being appraised is relatively new and has experienced little depreciation. In general, the reliability of the approach decreases as the depreciation of the property increases. This inverse relationship between the reliability of the approach and the extent of depreciation present arises from the difficulty inherent in estimating depreciation.

Cost, for appraisal purposes, may be thought of as "full economic cost." In general, full economic cost is the total payment that must be made to secure the supply of all of the agents necessary for production. Full economic cost consists of all expenditures necessary to place the completed property in the hands of the buyer or ultimate consumer.

In a unitary appraisal, the property being valued is the operating system. To create an operating system requires significant start-up costs—that is, costs incurred prior to the production of revenue that cannot be identified with a specific tangible asset. Start-up costs are a valid component of the total cost of the operating system because the system could not be reproduced or replaced without incurring them.

CONCEPTS OF COST

Reproduction Cost and Replacement Cost

Rule 6 authorizes an assessor to use a cost approach that is based on either *reproduction cost* or *replacement cost*. Reproduction cost, strictly construed, is an estimate of the cost of replacing the property being appraised with an exact replica, using costs as of the valuation date. This concept of cost is not often particularly useful to an appraiser, however, since reproduction cost is relevant to an estimate of a property's market value only if the property would actually be replaced by one that is identical in terms of design, materials, and workmanship. The property being appraised may incorporate elements that diverge from current market standards and that would therefore not be replaced by the typical buyer.

Replacement cost, in comparison, is the estimated cost to construct a property that is equivalent to the property being appraised in terms of utility as of the valuation date. It is this concept of cost that is validated by the principle of substitution, since, as discussed above, a rational person will pay no more for a property than the cost of acquiring a satisfactory—but not usually identical—substitute property.

Although distinct in concept, for a particular property, at a particular point in time, estimates of replacement cost and reproduction cost may be equal. For example, in the case of a newly built property constructed and designed in accordance with current market standards, the estimates of reproduction cost and replacement cost would tend to be the same.

Historical, or Original, Cost

Historical, or original, cost is the cost of a property when it was originally constructed and/or placed into service. As discussed below, historical cost, combined with a cost trending factor, can be used to estimate reproduction cost.[31]

ESTIMATING REPRODUCTION OR REPLACEMENT COST NEW

In general, reproduction cost or replacement cost can be estimated in two ways: (1) by adjusting a property's historical, or original, cost for price level changes and for abnormalities, if any, or (2) applying current prices to the property's labor and material components and adding, as appropriate, amounts for entrepreneurial services, interest on borrowed or owner-supplied funds, and other costs typically incurred in bringing the property to a finished state.

The Board uses the first of these methods to estimate reproduction cost new (ReproCN) or replacement cost new (ReplCN); that is, the historical cost of an assessee's property, typically segregated by year of acquisition, is multiplied by a cost index factor. Thus,

Historical cost x Cost index factor = ReproCN or ReplCN

The use of equipment index factors is practical for mass appraisal purposes, and numerous trade publications provide cost index factors. In the case of replacement cost, the equipment index factor (sometimes referred to as the trend factor) should recognize factors that affect the price of an equivalent replacement property. These include price changes and the effects of technological progress.

DEPRECIATION

The most difficult aspect of the reproduction and replacement cost approaches is estimating depreciation. In general, depreciation may be thought of as the difference between the present value of the property being appraised and the present value of a hypothetical, newly built,

[31] Although the terms are often used synonymously, some sources distinguish between "historical cost" and "original cost." Historical cost is defined as in the text, but original cost is used to designate the actual cost to the property's present owner, who may have acquired the property from a previous owner for more or less than historical cost. For example, a secondhand machine is bought for $50,000; the seller bought it new for $100,000. $50,000 might be called original cost (i.e., the cost to the secondhand buyer and present owner) and $100,000 the historical cost (i.e., the cost when new). To further complicate matters, "first cost" is sometimes used to mean historical cost.
Rule 6 uses "original cost" in the same sense as "historical cost." (In fact, "historical cost" does not appear in rule 6.) However, rule 6 uses "acquisition cost" in the sense that original cost is used in the preceding paragraph, stating, in subdivision (c), "If the property was not new when acquired by its present owner and its *original cost* is unknown, its *acquisition cost* may be substituted for original cost.…" [Emphasis added.] Got it?

modern property of equivalent utility. Thus, in the appraisal sense, the term "depreciation" refers not to a decline in the original value of the subject property, but rather to a measurement of the extent to which the property being appraised is, at a particular point in time, worth less than a hypothetical new property.[32]

The three recognized forms of depreciation are physical deterioration, functional obsolescence, and external, or economic, obsolescence. Physical deterioration is a loss in value that results from wear and tear caused by use and exposure to the elements. This type of depreciation is expected with most property. Functional obsolescence is a loss in value that results from the design of the property itself. When the capacity of a property to perform the function for which it was intended declines (for reasons other than physical deterioration or external obsolescence) functional obsolescence is present. External obsolescence, also called economic obsolescence, is a loss in value that results from adverse factors external to the property.

A property may suffer from one or more of these forms of depreciation. Some methods of estimating depreciation separately estimate an amount for each form, while others estimate depreciation as a whole, without attempting to attribute separate amounts to each form of depreciation.

ESTIMATING DEPRECIATION

There are several methods of estimating depreciation, and appraisers may use one or more of them. These include the market method, the percent good method, the straight-line or age-life method, the observed condition method, and the production output or services hours methods. The reader is referred to AH 502, “Advanced Appraisal,” and AH 504, “Assessment of Personal Property and Fixtures,” for discussions of these methods.

The Board estimates depreciation using a percent good method; estimating depreciation for state assessed property requires a mass appraisal method. Percent good, as a percentage, is the complement of depreciation. For example, if total depreciation is 20 percent, then percent good is 80 percent. The percent good concept is used in the appraisal process for two reasons: (1) it focuses the appraisal on the benefits remaining or the economic life remaining in the property rather than the benefits used; and (2) it saves one arithmetical operation when estimating market value.

The percent good factors for a given property type are based on the expected economic life of that property type. The expected economic life of a given property type, in turn, is based on a service life study using industry data for that type of property. Average service life can be

[32] The accounting concept of depreciation is distinct from the appraisal concept. In accounting depreciation, the rate of depreciation is established when an asset is new for the purpose of amortizing the asset’s original cost as a periodic expense. The book value shown on the accounting records is the asset’s original cost reduced by the accrued depreciation charges against it for financial reporting purposes. By contrast, depreciation for appraisal purposes represents actual loss in market value. An appraiser estimates the market value of a property by reducing its estimated cost new by the estimated depreciation affecting the property. It is highly unlikely that this value will equal the book value of the property found in the accounting records.

estimated by a mortality study of individual acquisitions and retirements, historical usage of property, useful life expectancy as reflected by the applicable industry, or other information as available. In addition to expected economic life, four other variables have an effect on percent good factors: the rate of return, the method of calculation, the survivor curve, and an income adjustment factor.

Percent good factors are designed to measure depreciation from all causes, but may not measure all external obsolescence. External obsolescence may be caused by increased competition, unexpected technological innovation and advance, legal restrictions on property use, and other factors. If a state assessee can document extraordinary depreciation resulting from external obsolescence, it will be considered in the final value indicator.

ESTIMATING REPRODUCTION OR REPLACEMENT COST NEW LESS DEPRECIATION

Given an estimate of reproduction cost new (ReproCN) or replacement cost new (ReplCN) and given an appropriate percent good factor, the calculation of reproduction cost new less depreciation (ReproCNLD) or replacement cost new less depreciation (ReplCNLD) is the simple product of the two.

ReproCN or ReplCN x Percent Good Factor = ReproCNLD or ReplCNLD

This produces an estimated market value for each type of property in the unit by year of acquisition. The summation of all these items is the estimated market value of the unitary property from the cost approach.

ADJUSTMENTS TO REPRODUCTION OR REPLACEMENT COST INDICATOR

Under the reproduction or replacement cost approach, the appraiser should consider adjustments to the initial value indicator that include, but are not necessarily limited to, the following:

- Nontaxable property and property assessed elsewhere
- Construction work in progress
- Leased property
- Taxable possessory interests

Nontaxable Property and Property Assessed Elsewhere. The value of property that is exempt from taxation (including the value of intangible assets and rights) or the value of property that is taxed in a different manner—such as the in-lieu fee for licensed motor vehicles—should be excluded from the reproduction or replacement cost indicator.

Nonunitary property may be assessed separately by the Board or the Board may delegate the assessment to a county assessor under certain conditions. The value of any nonunitary property should be excluded from the final reproduction or replacement cost indicator.

Construction Work in Progress. Construction work in progress (CWIP) is property under construction on the lien date, and the allowance for funds during construction (AFUDC) is the capital cost associated with CWIP. The value of both should be included in the final reproduction or replacement cost indicator.

Leased Property. As previously described, leases are generally one of two types: capitalized leases and noncapitalized leases. Unless locally assessed, the value of property under a capitalized or noncapitalized lease should be included in the final reproduction or replacement cost indicator.

Taxable Possessory Interests. The value of any taxable possessory interests should also be included the final reproduction or replacement cost indicator.

HISTORICAL COST APPROACH

The historical cost approach is an accounting-based method of valuation that develops a value indicator using the asset side of the balance sheet. More specifically, the value indicator is based on the historical cost less depreciation of the property being valued (HCLD). Historical, or original, cost is the cost of a property when it was originally constructed or placed in service. In the historical cost approach, depreciation means depreciation in the accounting sense—that is, the periodic expensing, or amortization, of a property's historical cost over its estimated life, in accord with the accounting methods prescribed by regulators or generally accepted accounting principles. In essence, property is valued based on its accounting book value.

Generally, the balance sheet value of an asset (i.e., its historical cost less accumulated depreciation) is not a good estimate of the asset's market value. The two primary reasons for this are inflation—the change in the value of the dollar relative to other goods—and the fact that the accounting depreciation charged against an asset is usually not equal to the actual change in the asset's market value over time.

However, the historical cost approach does present valid evidence of market value under limited circumstances. As provided in subdivision (d) of rule 3, this circumstance is when income from the property is rate-base/rate-of-return regulated and the regulator uses historical cost less depreciation as the rate base. The general practice of the California Public Utilities Commission, and other regulatory agencies, is to use HCLD (with some adjustments) as the rate base.

RATE-BASE/RATE-OF-RETURN REGULATION

The rationale of the historical cost approach is based on how rate-base/rate-of-return regulation works. In this form of economic regulation, regulatory agencies typically define the services a utility may provide, establish the rates the utility may charge, and prescribe the accounting system and methods to be used.[33] The allowed rate for the regulated service or product provided is set by the regulator at a level that allows, in theory, the regulated entity's aggregate revenues, its "revenue requirement," to equal its defined "cost of service." Cost of service includes operating expenses, an allowance for depreciation of capital, an allowance for income and property taxes, and a "fair" rate of return on the entity's "rate base." Rate base is, in essence, a proxy for the value of invested capital and is typically defined by most regulators, with some relatively minor adjustments, as the historical cost less depreciation of the regulated entity's assets.[34] A fair rate of return is generally construed as a competitive rate of return on capital on a risk adjusted basis. Thus,

$$\text{Revenue Requirements} = \text{Cost of Service, or}$$

$$R = O + D + T + kB,$$

[33] In the absence of regulatory reporting requirements, generally accepted accounting principles (GAAP) prescribe accounting methods, particularly pertaining to historical cost and depreciation, that may be used.

[34] The California Public Utilities Commission uses historical cost less depreciation in the development of the rate base.

where R is the revenue requirement, O is operating expenses, D is depreciation allowance, T is taxes, k is the competitive rate of return, and B is the rate base.

For a closely regulated entity, income is limited to a recovery of all costs, including the income required to produce a return on the rate base at the competitive cost of capital. To the extent, then, that historical cost less depreciation approximates the allowed rate base, it represents a valid indicator of the market value of the entity's property. In theory, a prospective buyer would pay no more than the rate base/historical cost less depreciation because the allowed net income is limited to a competitive return on this amount. Stated slightly differently, the regulated net income to the property, capitalized at a competitive rate of return, would equal the rate base/historical cost less depreciation.

Even if a rate-base/rate-of-return regulated utility sells, its rate base does not change. The rate base is not "stepped up" to reflect a purchase price higher than the existing rate base. Regulatory agencies, including the CPUC, use costs to the first owner—that is, historical cost—for ratemaking purposes. If a utility is purchased for more than its existing rate base, a regulatory agency generally requires the acquiring entity to capitalize the amount in excess of rate base in some type of "acquisition cost adjustment" account. The amortization of the acquisition cost adjustment is not allowed as an operating expense; rather, it is charged against "below the line" income. In this situation, investor-purchasers of rate-base/rate-of-return regulated utilities are not permitted to earn a return on their full capital investment (i.e., purchase price).

For several reasons, however, the revenue requirement of a firm subject to rate-base/rate-of-return regulation may deviate from its actual cost of service, and hence its rate of return on rate base may differ from the market return. One reason is regulatory lag. A utility's charges for service may not be reviewed for years, and even with frequent rate review, it may be politically difficult for the regulatory authority to adjust the charges. Moreover, a utility that is not subject to routine rate hearings is not likely to request a hearing for reduction in its revenue requirement in the face of an unanticipated decrease in costs or decline in market rates of return. A second reason is that the method of depreciation (i.e., capital recovery) prescribed by the regulatory agency may differ from the actual depreciation of the property, and therefore the market's perception of the value of the utility property may differ significantly from its book value. But even with these and other qualifications, the historical cost approach remains a valid indicator of market value of the property of a rate-base/rate-of-return regulated firm's whose rate base is based on historical cost.

ADJUSTMENTS TO HCLD INDICATOR

Under the historical cost approach, the appraiser should consider adjustments to the initial value indicator that include, but are not limited to, the following:

- Nontaxable property and property assessed elsewhere
- Construction-work-in-progress (CWIP) and the related allowance for funds during construction (AFUDC)

- Contributions in aid of construction (CIAC)
- Leased property
- Taxable possessory interests
- Deferred income taxes

Nontaxable Property or Property Assessed Elsewhere. The value of property that is exempt from taxation (including the value of intangible assets and rights) or the value of property that is taxed in a different manner—such as the in-lieu fee for licensed motor vehicles—should be excluded from the final HCLD indicator.

The initial value indicator may contain the value of both unitary and nonunitary property. Nonunitary property may be assessed separately by the Board or the Board may delegate the assessment to a county assessor under certain conditions. The value of any nonunitary property must be excluded from the final HCLD value indicator.

Construction Work in Progress and Allowance for Funds During Construction. As noted earlier, construction work in progress (CWIP) is property under construction on the lien date, and the allowance for funds during construction (AFUDC) is the capital cost associated with CWIP. Both should be included in the final HCLD unitary indicator.

Contributions in Aid of Construction. A contribution in aid of construction (CIAC) is property that is given to a utility in order to receive service. For example, a potential customer, often a property developer, may contribute property to a utility as an inducement to provide service for a development project. The developer's cost for CIAC property is typically recouped in the sales proceeds from the development.

The CIAC property of a regulated utility is excluded from its rate base. The reasoning is that the utility should not be allowed to either recover the cost (i.e., return of investment) or earn a profit (i.e., return on investment) on property it acquires without cost. CIAC property should also be excluded from the appraiser's HCLD value indicator. A prospective purchaser would not be expected to invest in property on which no return is allowed.

Leased Property. As previously noted, leases are generally one of two types: capitalized leases and noncapitalized leases. The value of a capitalized lease, since it is reported on the balance sheet, should be included in the initial HCLD indicator. Unless locally assessed, the value of property under a noncapitalized, or operating, lease should be included in the final HCLD indicator. Typically, it is added at its historical cost less depreciation.

Taxable Possessory Interests. The value of taxable possessory interests should be included in the final HCLD indicator.

Deferred Income Taxes. Deferred income taxes (DFIT) is a liability that largely arises from the use of accelerated depreciation for income tax reporting and straight-line depreciation for

financial reporting.[35] As a result, in the early years of an asset's life, the amount of income taxes payable is lower than it would have been had straight-line depreciation also been used for income tax reporting purposes. In the later years of the asset's life, the process reverses itself, and the amount of income taxes payable is greater than it would have been under straight-line depreciation.

The deferred taxes liability on a balance sheet represents income taxes that do not have to be paid currently but will have to paid in the future. The accumulated deferred taxes that have accrued over time for various assets make up the balance in the deferred taxes account. In the annual accounting for individual assets, the entries for some assets will increase the liability for deferred taxes and some will decrease it. For most firms, however, deferred taxes is a liability account.

Regulatory authorities require that the deferred income tax liability be deducted from HCLD in the calculation of the rate base. As a result, there is no return on the cost of property purchased with funds generated by deferred taxes; however, there is a return of the cost of such property through the depreciation expenses charged. A prospective purchaser of the utility property would also expect the same treatment.

The appraiser should adjust HCLD to reflect the fact that deferred taxes are not part of the rate base and therefore not part of the utility's revenue requirement. The mechanism of the adjustment should reflect the time value of money. Deferred, or unamortized, investment tax credits should be treated in a similar way.

[35] There are other timing differences between financial and tax accounting, such as vacation pay, bonuses, balancing account reimbursements, and interest, that may affect the amount of tax deferral.

INCOME APPROACH

The income approach—or capitalized earnings ability approach as it is sometimes called—assumes that buyers and sellers of property base their valuations on the income that a property is expected to produce. More precisely, the approach is based on the assumption that a property's value can be estimated by capitalizing, or discounting, the property's expected future monetary income to a present value amount, using a discount rate that reflects the risk associated with the expected income.

Hence, the income approach is best used to value property typically purchased for its expected future income and for which an income stream can be estimated. Under rule 8, the approach is preferred when reliable comparable sales data are not available and when the cost approaches are unreliable because of considerable depreciation or other factors. The critical variables in the income approach are the expected future income, that is, the income to be capitalized, and the rate of capitalization.

INCOME TO BE CAPITALIZED

Defining the Capitalized Income[36]

In general terms, the income, or cash flow, that is capitalized in public utility valuation is that which remains after deducting expected operating expenses from expected gross operating income. This level of income is prior to deductions for accounting depreciation, corporate income taxes, ad valorem property taxes, interest payments, or dividends. Income and property taxes, depreciation (i.e., the recovery of capital), and returns to debt and equity holders are all accounted for in the capitalization rate. Thus, the income and expenses used in valuation are cash flows. They are based on "cash in and cash out." They are not based on the accrual methods used in measuring accounting income. Cash flows reflect cash receipts and expenditures in the period when they are forecast to be received or expended. Although cash receipts and expenditures occur throughout the year, cash flows are conventionally expressed as annual flows occurring at the end of the year.

The income to be capitalized should be based on a forecast; that is, the estimate should be oriented toward the future. This requires a forecast of the expected gross income a property is expected to produce and a forecast of expected future operating expenses. Although the past and current experience of the property being appraised can be used as a guide, the forecast should not be a simple projection of past experience.

Income forecasts for public utility property normally start with an analysis of the income reported in the current income statement. This analysis may require adjustments to reported income and expenses for various reasons. For example, recent rate changes that are not fully reflected in current operating statements may have to be adjusted to a full year basis, and expenses that are unusual and nonrecurring may have to be removed.

[36] The income to be capitalized is also discussed in *Assessor's Handbook* Section 502, "Advanced Appraisal."

The income to be capitalized represents an expected value for each period over which the forecast is made. The objective of income and expense analysis is to arrive at an income to be capitalized that is the most probable from the perspective of a well-informed buyer. These expected values do not provide for risk, that is, the likelihood that the income will be received. The risk associated with the income is reflected in the capitalization rate.

Under California law, the unitary value of a utility or railroad must reflect only the value of the property that exists on the lien date. Future income growth and endurance resulting from future investment should not be considered in the income amount and duration estimates unless the costs of these future investments are expensed from the projected income stream. To do otherwise results in valuing property which does not exist on the lien date.

Duration of Forecast Income

Application of the income approach requires estimating the duration of the income to be capitalized. Income can be capitalized for an infinite period—in perpetuity—or over a finite, or limited, period. The Board uses both perpetuity and limited-life income models in its unitary valuations.

Capitalization of income for a limited duration obviously requires the selection of an appropriate period. In public utility valuation this is generally based an estimate of remaining economic life of property being valued. A single economic life is used for the unitary property by estimating a composite life expectancy for all property in the unit. This is accomplished by analyzing the life expectancies of the various assets that make up the unit and then weighting the relative importance of each asset's contribution to the unit's remaining life on the basis of each asset's cost.

Capitalizing income in perpetuity requires knowledge of replacement costs and replacement patterns. The provision for replacement investment in the model, in addition to the normal operating expenses associated with the unit, allows the perpetuity assumption. The replacement costs of assets having the same quality and capacity as the existing assets must be deducted from the annual income to be capitalized.

One difficulty with the perpetuity model is that most replacement investment is not pure replacement; the "replacement investment" results in improvements that increase plant quality and capacity, and thus also includes some new investment. Future anticipated growth investment should not be allowed as a deduction, nor should the anticipated income from the investment be capitalized. Future growth investment may affect the value of the company but does not reflect the value of the existing property that is subject to the appraisal. However, in some cases the future investment is necessary to fully utilize the existing property, and it is correct to include such increased income to the existing property.

DEVELOPING THE CAPITALIZATION RATE

Overall Rates versus Discount Rates

The general appraisal definition of a capitalization rate is any rate that is used to convert income into an estimate of value. Discussions about capitalization rates can get confusing because there seem to be so many different rates to distinguish. In fact, all capitalization rates can be placed into two primary types. Each type is derived and applied differently.

The first type of capitalization rate is usually called an overall capitalization rate or a direct capitalization rate. This type of rate is derived by dividing a single year's expected income from a property by the sale price of the property. For example, if the buyer's anticipated next-year's income from a property is $1 million and the sale price of the property is $10 million, the overall capitalization rate derived from this sale is $1 million/$10 million, which equals 0.10 or 10 percent. This overall rate could then be applied to a comparable property being appraised by taking that property's expected next-year's income and dividing by 0.10. Thus, an overall capitalization rate is a simple ratio between a property's defined level of income and the property's value. When property is valued using an overall, or direct, capitalization rate, the method of capitalization is called direct capitalization.

The second type of capitalization rate is called a discount rate or a yield rate. This type of capitalization rate represents a rate of return on capital. The return on capital is the amount an investor receives for the use of capital until it is recovered; it is what we generally think of as an interest rate. A discount rate is used to discount one or more payments into a present value amount. For example, a mortgage rate is a discount rate. If each future mortgage payment is discounted to a present value amount, the result should be the original amount of the mortgage (assuming it is a new mortgage). The discount rate should reflect the risk of the income being capitalized—the more variable the forecast income the higher the discount rate.

A discount rate can be derived from a sale if the buyer's anticipated income stream is known. The mathematical procedure is to calculate the discount rate at which the buyer's anticipated income stream is equal to the sale price of the property. A second way to derive a discount rate is to use the band of investment, or weighted average cost of capital, which is discussed below. When property is valued using a discount, or yield, rate, the method of capitalization is called annuity capitalization. The capitalization rate currently used by the Board in the valuation of unitary public utility property is a discount rate, and the method of capitalization is a form of annuity capitalization. More detail regarding the capitalization rate used by the Board is provided below.

A capitalization rate provides for an economic *return on* capital while the capital is invested. This is represented by the discount rate. In addition, if income is capitalized over a finite period—as opposed to in perpetuity—the capitalization rate requires a component for recovery of capital, which is referred to as the *return of* capital (or capital recovery).

Band of Investment/Weighted Average Cost of Capital

Under rule 8, a capitalization rate may be developed by deriving a weighted average of the separate capitalization rates for debt and equity. In a real estate valuation context, this technique is called the band of investment method. An analogous concept from corporate finance is the weighted average cost of capital (WACC). A WACC is developed by weighting the costs of (i.e., required rates of return on) a firm's permanent sources of financing—typically common stock, bonds, and, perhaps, preferred stock—obtained from capital market data, with the weights based on the relative market values of these components.

The Board's Valuation Division staff conducts an annual capitalization rate study to develop discount rates used in the valuation of unitary property on each lien date.[37] In essence, using capital market data, the staff develops WACCs, or discount rates, for various industries and subgroups within industries. This requires obtaining and analyzing data by industry type for the percentage of debt and equity that make up the capital structure, the current cost of debt capital, and the current cost of equity capital. These data are further categorized by industry subgroups depending on bond ratings, size of investment, income tendency, and growth potential. The purpose of this grouping is to ascertain a rate of return for the different types of property with equivalent risks.[38]

From Basic Capitalization Rate to Total Capitalization Rate

As discussed in the earlier section concerning the income to be capitalized, no deductions for capital recovery (i.e., depreciation), income taxes, and ad valorem property taxes are made from the income to be capitalized—rule 8 specifically excludes these items from the definition of "gross outgo." Components for these items are instead added to basic capitalization rate, that is, the discount rate, in order to arrive at the total capitalization rate used by the Board.

The total capitalization rate, therefore, contains these four components: the basic capitalization rate (sometimes called the yield component); a capital recovery, or capital recapture, component; an income tax component; and an ad valorem property tax component. Thus:

1. The basic capitalization rate is developed using the band of investment/weighted average cost of capital technique described in the preceding section.

2. The capital recovery component provides for the periodic recovery of invested capital over a specified period. Two variations of capital recovery are used: level annuity capital recovery and straight-line capital recovery. In level annuity capital recovery, a sinking fund factor from compound interest tables is added; in straight-line capital recovery an amount calculated by dividing one by the remaining economic life is added. In perpetuity capitalization, no capital recovery component is needed because capital recovery is allowed as a deduction from the income to be capitalized.

[37] The annual study is available on request.

[38] The general method of deriving a weighted average cost of capital is covered in most finance texts. For example, see Eugene F. Brigham and Louis C. Gapenski, *Intermediate Financial Management* (New York: The Dryden Press, 1993).

3. The property tax component is the estimated rate of ad valorem property taxation that a typical buyer would anticipate. This rate may vary slightly by assessee.

4. Finally, the income tax component is based on the income tax rate that a typical buyer would anticipate. The component allows for state and federal corporate income taxes. This adjustment is necessary because the basic capitalization rate is developed on an after-corporate income taxes basis while the income to be capitalized is developed on a before-corporate income taxes basis.

The development of the total capitalization rate is summarized below.

	Basic Capitalization Rate	Discount, or yield, rate developed by industry group or subgroup in annual capitalization rate study.
+	Capital Recovery Component	Not added in perpetuity income model (annual replacement investment deducted from capitalized income). In limited-life income model, may be an amortization factor from financial tables or a "straight-line" factor.
+	Income Taxes Component	Required to convert basic capitalization rate derived on after-income taxes basis to before-income taxes basis. Income to be capitalized is before income taxes.
+	Property Taxes Component	Ad valorem property taxes accounted for in capitalization rate, not capitalized income.
=	Total Capitalization Rate	Income to be capitalized is divided by this rate to arrive at the initial (i.e., before any required adjustments) unitary income approach indicator.

INCOME MODELS USED BY THE BOARD

The Board uses two income capitalization models: a perpetual life model and a limited life model. The perpetual life model assumes that assets are replaced as they are retired, that is, that there is annual replacement investment to replace the assets "used up." In this model, the capital investment necessary to maintain a perpetual income stream is deducted from the income to be capitalized. In other words, it is assumed that with the necessary annual investment the income stream can be sustained in perpetuity. This is the Board's primary income model.

In circumstances in which a perpetuity assumption is dubious, a limited-life model is used. With the limited-life model, the periodic income to be capitalized is forecast over a finite period and the incomes, or cash flows, are discounted to a present value estimate. Any estimated value remaining at the end of the finite period is also discounted to present value and added to the present value of the periodic income.

The limited-life model is developed in two variants: one that assumes level-annuity capital recovery and one that assumes straight-line capital recovery. In level annuity capital recovery, the appropriate sinking fund factor is added to the basic capitalization rate. In straight-line capital recovery, an equal annual amount of capital recovery over the property's remaining economic life is provided in the capitalization rate.

In addition to the primary models above, a net liquidation value model is occasionally used when liquidation of an assessee's unitary property appears more economically feasible than its continued operation as a going concern. This represents a minimum value indicator for a state assessee. The model is a basic application of discounting: the estimated value of each category of property is discounted to a present value estimate given an estimated time for liquidation, and the present values for each property category are summed. The net liquidation value model might also be viewed as a special application of the comparative sales approach, since in order to establish liquidation values techniques of that approach are used.

ADJUSTMENTS TO INCOME APPROACH INDICATOR

As with the other approaches, the initial value indicator from the income approach may require adjustments. Deductions may be required to remove the value of nontaxable and other property from the unitary indicator, and additions may be required to include the value of taxable property whose income is not reflected in the income that is capitalized. Under the income approach, the appraiser should consider adjustments to the initial value indicator that include, but are not limited to, the following:

- Nontaxable property and property assessed elsewhere
- Working capital allowance
- Construction work in progress
- Contributions in aid of construction
- Future use property

Nontaxable Property and Property Assessed Elsewhere. The value of property that is exempt from taxation (including the value intangible assets and rights) or the value of property that is taxed in a different manner should be excluded from the final income approach indicator.

The initial income approach value indicator may contain the value of both unitary and nonunitary property. The value of any nonunitary property must be excluded from the final income approach value indicator. The methods for removing the value of nonunitary property from an initial indicator were briefly described in a preceding section—that is, the income influence method, the book value method, and the direct appraisal method.

Working Capital Allowance. Working capital provides liquidity for a firm; it is the amount by which a firm's total current assets exceeds its total current liabilities. An investment in working capital is necessary because in most business operations the pattern of cash expenditures does not match the pattern of cash receipts.

Working capital is exempt from property taxation, and must be removed from the value indicator. Subdivision (e) of rule 8 prescribes that an amount equal to a competitive return on the firm's average working capital investment should be deducted from the income to be capitalized.

Construction Work in Progress. Construction work in progress (CWIP) is property under construction on the lien date, and allowance for funds during construction (AFUDC) is the capital cost associated with CWIP. Since the income to be capitalized does not reflect the earning power of CWIP intended for plant expansion or growth, the value of the growth CWIP (including AFUDC) should be added to the capitalized earnings. CWIP merely replacing existing plant and not adding additional capacity or earning ability is considered to be reflected in the income to be capitalized.

Future Use Property. Future use property is property owned by a utility that does not contribute to current income but is being held for future use. Future use property not included in the rate base and not assessed as nonunitary property should be included in the final income indicator.

Leased Property. Unless locally assessed, the value of leased property should be included in the income approach value indicator. The value of leased property is included in the indicator by not allowing the lease payment as a deduction from the income to be capitalized.[39] In the perpetual life model, the allowance for capital replacement should also include an allowance for the replacement of leased property.

[39] See subdivision (c) of rule 8.

CHAPTER 5: ALLOCATION OF UNITARY VALUE

If the unit value contains the value of unitary property located outside California, a portion of the multistate unit value first must be allocated to California. The allocation of unit value between or among states is called interstate allocation. The unitary value indicators prepared for the Board by staff are post-interstate allocation; that is, staff has already made any necessary interstate allocations.

California's portion of the multistate unit value must also be allocated among the state's local tax jurisdictions. The allocation of unit value within a state is called intrastate allocation. If all of a state assessee's unitary property is located in California, obviously no interstate allocation is required.

The values for all state-assessed property appear on what is called the "board roll." Under section 756, on or before each July 31, the Board must provide each county auditor with a roll showing the values for all state-assessed property located in his or her county. The state assessments are levied, and the corresponding property taxes collected, at the county level.

Unfortunately, no method of allocation can be theoretically satisfying from a valuation perspective if one accepts the principle of unit valuation. The allocation of a unit value, which is an attempt to obtain separate market values for the component parts of an operating unit, contradicts the principle of unit valuation. If it is not possible to add up the separate values of the component parts of an operating unit to determine the value of the unit—in essence, the principle of unit valuation as it is applied to public utility property—then it is equally impossible to determine the separate market values of the component parts by breaking up the value of the unit. Unit valuation is thus logically inconsistent with any method of value allocation that purports to be according to market value.

Theoretical problems aside, the need for inter- and intrastate allocation, and hence the need for an allocation method, is based on clear legal requirements. First, under federal law California, like all other states, has no authority to tax property located outside its boundaries. Second, section 14 of article XIII of the California Constitution requires that "All property … shall be assessed in the county, city, and district in which it is situated."

The result is that allocated amounts, in both inter- and intrastate allocation, in a strict sense do not represent market values; rather, they are portions of the unit value allocated in an equitable and systematic manner to allow assessment and taxation by the appropriate legal jurisdiction.

The following sections describe, in general terms, the Board's procedures for the inter- and intrastate allocation of a unit value. These procedures, although based on the same concepts, vary by industry and by whether the allocation is inter- or intrastate. A concluding section also briefly

describes the Board's tax-rate area system, the means by which all property in California is assessed according to its situs.[40]

INTERSTATE ALLOCATION

BASIS FOR INTERSTATE ALLOCATION

Both the National Association of Tax Administrators (NATA) and the Western States Association of Tax Administrators (WSATA) have made recommendations regarding the interstate allocation of unit value. In 1949, NATA, based on work by its Committee on Railroad Allocations, adopted an allocation formula for railroads; and in 1960, WSATA, based on work by its Committee on Allocation of Public Utilities, recommended allocation formulas for other types of utility property. In general, the Board follows NATA's and WSATA's recommendations regarding interstate allocation methods.

The Board considers several general principles in its allocation criteria. Largely derived from NATA and WSATA, they include the following:

- Allocation percentages should not total more or less than 100 % for all states.
- Allocation factors should reflect the quantity of property in each state.
- Allocation factors should be based on readily available, objective data.
- Allocation factors should not be based on data that are the result of a prior allocation.
- The resulting allocation should be "fair and equitable."
- The allocation method should consider administrative feasibility and convenience.
- As much as possible, the allocation should divide the unit value in proportion to the contribution made by the unitary property in each state to the unit value (despite the theoretical difficulty related to this).

In practice, the interstate allocation of unit value is based on an allocation factor or, more typically, a combination of allocation factors. An interstate allocation factor is intended to measure the importance of a given variable in a state relative to its importance in the unit as a whole. For example, if the variable is the historical cost of the property, the historical cost of the

[40] A few points about interstate allocation that are well known to those involved but perhaps not obvious to others: (1) Each state estimates its own unit value, and each state may define the unit slightly differently. Further, tax law may vary between states as to what is or is not subject to ad valorem property tax. So, if a given assessee operates in, say, three states, three unit values will be estimated. (2) Prior to the efforts of NATA and WSATA, there was only limited agreement regarding allocation formulas. This meant that the total percentages allocated by the respective states could sum to significantly more or less than 100%. This problem has been largely rectified. (3) There is an abundance of federal court cases concerning allocation of various types of interstate property. In general, the federal courts will strike down allocation systems they deem unreasonable. Beyond that, the federal courts have declined to interfere with a state's allocation system that is based on some reasonable relationship to the rights and benefits of having the property located in the state. There is no federal requirement that the total of all state assessments must equal (or cannot exceed) 100 percent.

property in a given state is divided by the historical cost of all the property in the unit. The quotient is an allocation factor based on historical cost. When the allocation factor is multiplied by the unit value, the product is the state's portion of the unit value.

Often, two or more allocation factors, reflecting different allocation variables, are combined. When factors are combined, weights are assigned to each factor. The result is a composite factor—a weighted average of the individual factors—that is then used for allocation. Different composite factors can be developed using different individual factors and different weightings. The calculations required to arrive at a composite allocation factor are often called the "allocation formula."

Individual allocation factors are generally based on property, use, or revenue variables. Property factors are based on the visible, physical assets in the unit, such as cost (original, or historical; reproduction; or replacement), wire-miles, pole-miles, track-miles, distribution mains, etc. Use factors are based on some type of physical activity that takes place, such as car-days, car- or locomotive-miles, ton- or passenger-miles, barrel-miles, MCF-miles (MCF = thousand cubic feet), originating- or terminating-tons, and kilowatt hours-sold or kilowatt hours-generated. Revenue factors represent some measure of earnings, such as gross revenue and net operating income. Revenue factors are sometimes interpreted as measures of "economic use" and are considered as part of the use category.

The specific procedures used in interstate allocation vary by industry, but the methods are similar. The Board's procedures for the interstate allocation of unit values are described briefly below, by industry group.

INTERSTATE ALLOCATION PROCEDURES

Electric

Electric utility companies often have unitary property used for the generation, sale, transmission, and distribution of electricity—or a combination of these operations—in more than one state. For the interstate allocation of an electric company's unit value, the Board follows WSATA's interstate allocation formula for electric utilities.

The WSATA formula allocates unit value on the basis of historical cost modified by other allocation factors. Separate allocations are made according to defined operating segments: electric production property, electric distribution property, and remainder of property. Allocation factors and factor weightings used for the three defined operating segments are as follows:

- Electric production property: 75% historical cost; 10% kilowatt capacity; and 15% kilowatt hours generated.
- Electric distribution property: 50% historical cost; 10% kilowatt hours delivered and sold; and 40% for revenues from these kilowatt hours.
- Remainder of property: 100% historical cost.

Thus, the value of the electric production segment is allocated using a composite allocation factor composed of three individual allocation factors—historical cost, kilowatt capacity, and kilowatt hours generated; the value of the electric distribution segment is allocated using a composite allocation factor composed of three individual allocation factors—historical cost, kilowatt hours delivered and sold, and revenue; and the value of the remainder of the property is allocated using a single allocation factor—historical cost.

These three factors are then multiplied by allocated percentages of the unit value for each operating segment; this percentage allocation is based on the historical cost of the property in each segment. The sum of these three products is the final allocation factor for California; when this factor is multiplied by the entire unit value, the result is the portion of the unit value assessed in California.

Telecommunication

A telephone company differs from other utility companies because of the structure of the telephone industry: typically, a telephone company can only operate, or operate most efficiently, when connected to other telecommunications systems. There is a high degree of system interdependence.

Telephone companies can be classified into three types: local exchange, interexchange, and wireless. Local exchange companies provide services in a defined geographic area, usually within a single state. In the case of multistate local exchange companies operating in California, the geographic area served, amount of property, and revenues in California generally are very limited. Nonetheless, in such cases, the interstate allocation of the unit value is still required. Typically, the Board makes this allocation using a single allocation factor based on historical cost.

Interexchange companies provide telephone services from one local exchange to another local exchange. Often, an interexchange company provides services in more than one state. The Board's interstate allocation of the unit value of an interexchange company is also made using a single allocation factor based on historical cost.

A wireless telephone company provides mobile telecommunication services through its own facilities, facilities owned by other wireless companies, and facilities owned by local and interexchange companies. Wireless companies own or lease sites, towers, and antennas in numerous counties throughout the state and may own or lease property in other states. For wireless companies, the Board makes its interstate allocation of unit value using an allocation factor based on gross revenue.

Pipeline

Pipeline companies own property used in the distribution of oil, natural gas, and other products in a liquid state; their operations are frequently interstate. The property involved can be divided into two categories: the pipeline itself and "other property," which includes buildings, gathering

systems, pumping stations, materials and supplies, and other assets that are not part of the pipeline itself but are used in the pipeline company's operations.

With pipeline companies, it is practically impossible to arrive at earnings estimates that can be ascribed to property on a state-by-state basis. Barrel-miles or MCF-miles are reasonable substitutes for earnings. Other appropriate allocation factors are those based on original or historical cost and originating and terminating barrels or MCF.

The Board typically uses a slightly modified form of the WSATA recommended allocation formula that includes the historical or original cost of pipeline and other property, barrel- or MCF-miles, and originating and terminating barrels or MCP as allocation factors, weighted as follows:

- Historical or original cost: 75%
- Barrel- or MCF-miles: 20%
- Originating and terminating barrels or MCF: 5%

When originating and terminating barrels or MCF data are not available, Board practice has been to modify the above formula by giving a 75% weighting to historical or original cost and a 25% weighting to barrel- or MCF-miles.

Railroad

For the interstate allocation of railroad unit value, the Board uses a modified version of the NATA formula. The modifications:

- Undepreciated cost is used because cost data are readily available and estimates of depreciation are not necessary.
- Rolling stock and other mobile equipment costs are excluded because they are based on allocations.
- Miles of way and yards of tracks are included to reflect terminal activity in California.
- Fixed weightings are assigned to the property, line haul, and terminal factors because the Surface Transportation Board (formerly, the Interstate Commerce Commission) no longer provides the expense data necessary to calculate weights.

The Board uses a composite allocation factor to allocate railroad unit value. The individual allocation factors and their weightings in the composite factor are as follows:

- Cost (Surface Transportation Board form R-1), a property factor: 40%
- Revenue ton-miles, a line-haul factor: 45%
- Sum of tons of originating and terminating freight, tons received and delivered, and miles of yard and way switching track, a terminal factor: 15%

The Board uses data from the Surface Transportation Board to calculate the individual allocation factors.

INTRASTATE ALLOCATION

BASIS FOR INTRASTATE ALLOCATION

Except for railroad property and property subject to subdivisions (i) and (j) of section 100, both of which are discussed in sections below, the intrastate allocation of unit value is to the county level only; the county auditor is responsible for further allocation of this value among the county's local tax jurisdictions. As stated in section 745:

> "The assessment of the unitary and operating nonunitary property of an assessee shall be allocated … among the counties in which parts of the unitary and operating nonunitary property are situated."[41]

Section 745 provides broad discretion to the Board regarding the method of allocation. The Board's primary objective is to use an allocation method resulting in an allocation of value to each county that is a reasonable estimate of the allocated part's proportionate value contribution to the intrastate unit value. In other words, the objective is for an allocation to each county that is as closely related as possible to the value of each assessee's unitary property in the county. Excluding the exceptions discussed below, intrastate allocation procedures, unlike interstate procedures, do not vary significantly by industry.

INTRASTATE ALLOCATION PROCEDURES[42]

Unitary Land

Board appraisers estimate the market values of each state assessee's unitary land parcels for each lien date, using generally accepted appraisal methods. The total unitary land value for each state assessee is the sum of the values of the assessee's unitary land parcels. This total unitary land value is allocated to each county based on situs (i.e., to each county's general countywide tax-rate area).

Unitary Property Other Than Land

The value of each assessee's unitary property other than land remains to be allocated. For each assessee, this amount is the assessee's total unit value less the value of the assessee's unitary land as determined in the section above. This is often called the "net unit value." The allocation of net unit value to each county is further segregated into improvements and personal property.

[41] The county auditor's intracounty allocation of unitary value among the myriad local tax jurisdictions must follow the formula prescribed in section 100.

[42] Again, the discussion in this section excludes railroad property and property subject to subdivisions (i) and (j) of section 100

For the property of the seven largest state assessees and for all pipeline property, the intrastate value allocation of the net unit value is based on reproduction cost new less depreciation (ReproCNLD). The allocation factor for a given assessee's property in a given county is the ratio between current ReproCNLD of the assessee's property in that county to current ReproCNLD of the assessee's net unit value.

For the remaining state assessees, those other than the seven largest, the allocation method is analogous, but the intrastate allocation factor is based on historical cost rather than ReproCNLD.[43]

Unitary property other than land includes property that is identifiable by location—buildings, substations, equipment, furniture, etc. For each property item, the assessee reports the original cost by acquisition year, and the location by general countywide tax-rate area (i.e., to the county level).

Also included in unitary property other than land are gas transmission and distribution mains, electrical transmission and distribution lines, telephone wires and cables, canals, pipelines, etc., all examples of a type of unitary property called "continuous structures." For intrastate allocation, the Board treats continuous structures in the same manner as property identifiable by location. For each portion or segment of a continuous structure, the assessee reports its original cost by acquisition year and its location by general countywide tax-rate area (or, if not so reported, Board staff will allocate the "continuous structures" by county).

Intrastate Allocation Summary

The guiding principle of intrastate allocation is location, or situs, with value allocated to situs using allocation factors based on either ReproCNLD or historical cost. Here is a 2-step summary:

1. Board staff estimates an assessee's unitary land value and allocates this value by location to each general countywide tax-rate area. The value of unitary property other than land, the "net unit value," remains to be allocated. For each assessee, this is the assessee's total unit value less the assessee's total unitary land value.[44]

2. For the seven largest state assessees and all pipeline assessees, the value remaining, the net unit value, is allocated to the county level using an allocation factor based on ReproCNLD. For all other assessees, the remaining unit value is allocated to the county level using an allocation factor based on historical cost. Allocated values are differentiated by "improvements" and "personal property." The sum of the allocated values for each county equals 100% of the Board-adopted unitary value.

[43] We have eliminated one slight complication. "Materials and supplies" are typically directly deducted from the assessee's total unit value and allocated to each county by situs based on their full reported cost. The "net unit value" referred to above is thus actually the total California unit value less the value of unitary land less the value of deducted materials and supplies. The amount of materials and supplies is generally not significant relative to the total allocated value.

[44] Intercounty pipeline *land and rights of way*, however, are locally assessed.

EXCEPTIONS TO GENERAL INTRASTATE ALLOCATION METHOD

Railroad Property

Railroads are an exception to the general intrastate allocation method based on ReproCNLD or historical cost. Section 100.1 governs the intrastate allocation of the value of the property of regulated railway companies. The unit values of railroad company property, unlike the unit values of other public utility property, are allocated to specific county tax-rate areas, not to the general, countywide tax-rate area. Also, the unit values of railroads are allocated based on estimated weighted track mileage in each tax-rate area, using a 1987 base year. Track mileage is weighted to reflect the relative importance of track type (e.g., mainline, branch, and other track). Further allocation among land, improvements, and personal property is also proportional to values from the 1987 base year.

Other Property Allocated to Specific Tax-Rate Area

Another exception to the general intrastate allocation method described above is property specifically described in subdivisions (i) and (j) of section 100 (sometimes called "Hannigan property," after the legislator). These subdivisions pertain to property that is undeveloped, owned by a public utility, and located within a city, county, or city and county that has adopted a resolution making the property subject to a development plan or agreement. A copy of the resolution also must have been transmitted to the Board before specified dates. The value of this property also must be allocated by specific tax-rate area rather than general countywide tax-rate area.

State assessees report such property's historical, or original, cost by acquisition year and its location by specific local tax-rate area. The value of this property is directly allocated to the specific tax-rate area within which the property is located, using an allocation factor based on historical cost. As described earlier, the value of all other unitary property in a county is allocated only to the countywide tax-rate area.

STATE ASSESSED PROPERTY NOT SUBJECT TO UNITARY ALLOCATION

The preceding sections described how the value of unitary property was allocated to the board roll and hence, eventually, to each local assessment roll. The remaining discussion focuses on how the rest of state-assessed property—that is, nonunitary property, operating nonunitary property, and nonunitary rail transportation property—is assessed and enrolled.

Nonunitary property is valued separately from the unit and its value is enrolled to the board roll by specific county tax-rate area. The value of nonunitary property is not subject to the intracounty allocation performed by county auditors under section 100.

Operating nonunitary property is valued separately from the unit but enrolled to each county's general countywide tax-rate area by situs (actually to a special, countywide tax-rate area reserved for it). Operating nonunitary property is subject to the intracounty allocation performed by county auditors. So, it receives a hybrid treatment (i.e., separately valued, but with value allocated).

Nonunitary rail transportation property is valued separately from the unit and its value is enrolled to the board roll by specific tax-rate area. The value of nonunitary rail transportation property is not subject to the intracounty allocation performed by county auditors under section 100. The value of this type of property receives the assessment ratio treatment described in an earlier section relating to the Railroad Revitalization and Regulation Reform Act (4-R Act). Excluding this treatment under the 4-R Act, nonunitary rail transportation property is treated exactly as nonunitary property.

BOARD'S TAX-RATE AREA SYSTEM

The Board's tax-rate area system facilitates compliance with the constitutional requirement that all taxable property be assessed according to situs. The tax-rate area system assigns a unique tax-rate area number to every geographical area in the state that corresponds to a unique combination of overlapping tax levies made by local revenue districts (e.g. cities, school districts, special districts) A general, countywide tax-rate area number is also part of the system.

A tax-rate area number contains 6 digits. The first 3 digits refer to primary areas and the second 3 digits to secondary areas. The primary-area digits identify incorporated cities and school districts in unincorporated areas of a county The secondary-area digits identify all other revenue districts within a given primary-area digits sequence. Since the geographic boundaries of these districts do not conform to those of the primary area numbers, subdivisions within the primary areas were created and numbered in ascending order beginning with "001."[45]

State-assessed property is identified by "000" in the primary-area digits of the tax-rate area number; unitary and operating nonunitary property are identified by "001" in the secondary-area digits. State assessees generally report their unitary property by countywide tax-rate areas. The Board then assesses the unitary property to the respective countywide tax-rate areas (except for railroad property and property subject to subdivisions (i) and (j) of section 100) and delivers the portion of the board roll pertaining to each county to the respective county auditor. As discussed above, nonunitary property and nonunitary rail transportation property are identified to the level of specific county tax-rate area.[46]

[45] Los Angeles County maintains its own five-digit numbering system, which does not completely differentiate cities from other districts.

[46] The Board's tax-rate area system is described in slightly greater detail in *Assessors' Handbook* Section 215, "Assessment Map Standards."

CHAPTER 6: APPEALS OF STATE ASSESSMENTS

The chapter discusses appeals of state assessments. Under sections 731 and following, a state assessee or its designated representative may request a review of the value of its unitary and/or nonunitary property and any related penalty assessments, the allocation of the unit value of its unitary property among counties; and the results of a Board audit resulting in escape assessments. The Board sits as the administrative appeals body for state assessments.[47]

The chapter begins with a brief discussion of the valuation process as it relates to appeals of state assessments. This is followed by a discussion of the appeals process, including declarations of intent and petitions for filing an appeal, conduct of Board hearings, and further appeal rights of state assessees. A brief discussion of the audit review process and escape assessments resulting from an audit concludes the chapter.

VALUATION PROCESS

Each year, the Board's Valuation Division prepares value indicators for state-assessed property as of the January 1 lien date in that year, and submits its value indicators and value recommendations to the Board. For unitary property, values are established by the Board at public hearings in May. For nonunitary property, values are established by the Board at public hearings in June.

As discussed in Chapter 5, the Board allocates the unit value of a state assessee's unitary property and assigns the value of its operating nonunitary property to each county in which such property is physically located. All other state-assessed property is assessed directly to the specific county tax-rate area in which the property is physically located. All assessments made by the Board appear on an annual Board-prepared assessment roll—the "Board roll"—that is sent to county auditors.

Assessee Review and Comment. Prior to the Board's annual valuation, a state assessee may review the staff's annual capitalization rate study and its work papers related to value indicators for *unitary* property.

The Board also provides a state assessee with the opportunity to make a presentation to the Board, either in person or in writing, regarding capitalization rates and other matters affecting the Board's valuation of its property. The Board holds public meetings in February and May for these purposes.

Notification of Value. After the Board establishes annual values for all state-assessed property, all state assessees are sent notices of assessment that also provide information on the procedure for appealing assessments.

[47] The Board also hears property tax appeals concerning assessments of taxable property owned by local governments outside their boundaries ("section 11 property") and claims for the welfare exemption that have been denied by Board staff.

Notices of assessment are mailed by June 1 for unitary property and by June 30 for nonunitary property. A property's assessed value becomes final 20 days after the mailing date of the notice, unless the assessee files either a declaration of intent to petition for reassessment or a petition for reassessment. If an assessee first files a declaration of intention to file a petition for reassessment, a subsequent petition for reassessment also must be filed in a timely manner; if not, the assessment becomes final 30 days after the last day for filing the declaration.

After receiving the notice of assessment, a state assessee may obtain, by written request, a copy of the appropriate staff capitalization rate study and the final calculations of value indicators relevant to the property to which the notice pertains. If requested, this information must be provided to the assessee prior to the deadline for filing a petition for reassessment.

Tax Payment. Tax is payable to the appropriate county or counties in two installments on November 1 (payment deadline December 10) and February 1 (payment deadline April 10).

APPEALS PROCESS – ASSESSMENTS AND PENALTIES

The appeals process is the same for both unitary and nonunitary properties, unless noted otherwise. The five basic steps in the appeal of a value established by the Board are as follows:

1. File a declaration of intent to petition for reassessment with the Board
2. File a petition for reassessment, a petition for reassessment and claim for refund, a petition for correction of an allocated assessment, or a petition for penalty abatement with the Board
3. Submit the matter for hearing by the Board (if the assessee does not request an oral hearing, the Board will base its decision on the contents of the written petition and the written recommendation made by the Board's staff)
4. File a claim for refund with the county, if not previously filed with the Board (taxes must be paid to county or counties)
5. File an action in superior court (if claim for refund is denied)

Although the appeals process generally proceeds step-by-step, some steps may be combined or skipped, as explained in the following section.

DECLARATION OF INTENT TO PETITION FOR REASSESSMENT

The declaration of intent notifies the Board that the assessee intends to file a petition for reassessment of its unitary or nonunitary property. The declaration may be in the form of a letter and must include information sufficient to identify the property and the name of the property owner—whether an individual, partnership, or a corporation. An assessee may forego filing a declaration of intent and simply file a "Petition for Reassessment" within the time period prescribed for filing the declaration.

A declaration must be mailed or hand-delivered to the Board within 20 calendar days of the mailing date of the Board's notice of assessment for the subject property. As previously mentioned, an assessment will become final if either a declaration of intent or a petition for reassessment is not filed by the end of the 20-day period.

PETITION FOR REASSESSMENT, PENALTY ABATEMENT, OR CORRECTION OF ALLOCATED ASSESSMENT

Petition for Reassessment or Petition for Penalty Abatement. The time limit for filing a petition depends on whether a declaration of intent has been filed. If a declaration of intent has been timely filed, the petition must be filed within 30 days of the end of the 20-day filing period for the declaration. If a declaration is not filed, the petition must be filed within 20 days of the mailing date of the Board's notice of value. Under section 758, the assessment will become final if either a declaration of intent or a petition of reassessment is not filed within 20 days of the mailing date of the Board's notice of value.

The petition for reassessment or the petition for penalty abatement must be in writing. The petition for reassessment must state

- the name of the property owner;
- the assessee's opinion of the property's value; and
- the precise elements of the Board's valuation being contested[48].

The petition for penalty abatement must present facts establishing that

- there was a reasonable cause for the inaccurate or delayed filing;
- the problem occurred despite best efforts to file an accurate and/or timely statement; and
- the assessee did not intentionally neglect its filing obligations.

If the assessee wants to make an oral presentation before the Board, the request must be included in the petition. Otherwise, the Board will consider the merits of the written petition and the Board staff's written recommendation and make its decision at a public meeting (nonappearance agenda).

The petition may serve as a claim for refund of taxes to be paid on the assessment that is the subject of the petition. If the petition serves as a claim for refund, it should state this clearly.

The Board hears petitions for reassessment of unitary and nonunitary values or penalty abatement between the date a timely petition is received and December 31 of the same year. The Board must reach a decision on such petitions no later than December 31.

[48] Appraisal reports, financial studies and other materials relevant to value must be included and submitted with the petition for both reassessment and for penalty abatement.

Petition for Correction of Allocated Assessment. On or prior to completion of the Board roll, the Board must send each assessee a written notice of the allocated assessed values of the assessee's unitary property. An assessee may appeal the value allocation of its unitary property by filing a petition for correction of an allocated assessment. The filing deadline is within 10 days after the mailing date of the notice of allocated assessed values. In the petition, the assessee must state the specific reasons on which the claim for correction or adjustment of the allocation is grounded. Under a petition for correction of an allocated assessment, the assessee may not contest the total value of its unitary property; only the allocation of the unit value may be contested. The petition may serve as a claim for refund of taxes to be paid on the assessment that is the subject of the petition. If the petition serves as a claim for refund, it should state this clearly.[49]

BOARD HEARING

The Board hearing gives the assessee the opportunity to summarize and emphasize the points supporting its position. An assessee may present any relevant evidence, provided it is the sort of evidence generally relied upon by responsible persons in establishing value for similar properties.

At the hearing, the Board will generally consider only the values, issues, or precise elements set forth in the petition. However, the Members may inquire into relevant new matters and give the assessee or the Board staff an opportunity to respond.

Burden of Proof

Ordinarily the assessee has the burden of proof regarding any disputed facts. In a hearing on a petition for abatement of a penalty for failure to file an accurate and/or timely property statement, under section 830 the assessee must establish to the Board's satisfaction that

- there was reasonable cause for the inaccurate or delayed filing;
- the problem occurred despite best efforts to file an accurate and/or timely statement; and
- filing obligations were not intentionally neglected.

In a hearing on a petition for abatement of other penalties, however, Board staff bears the burden of proof.

Conduct of the Hearing

A Board hearing generally consists of the assessee's unsworn presentation, presentations by Board staff (usually an appraiser and an attorney), and, if necessary, testimony by witnesses. If the assessee requests, the Board will conduct a formal evidentiary hearing in which witnesses testify under oath or affirmation.

[49] Under sections 5096 through 5097.2, a claim for refund of taxes paid more than once or erroneously or illegally collected or levied must be made in writing, specifying the grounds on which the claim is founded, and must be filed within four years after making the payment sought to be refunded, or within one year after the mailing of the tax collector's notice of overpayment, whichever is later.

A hearing usually proceeds as follows:

1. A Board staff attorney introduces the case by summarizing the facts, applicable law, and issues involved. If an assessment is at issue, the attorney will offer into evidence the Board's determinations of value. Following this introduction, the staff attorney will introduce the assessee or the assessee's representative.

2. In a case in which the assessee bears the burden of proof, the assessee or the assessee's representative states its position regarding the facts and applicable law and presents its evidence.

3. After the assessee's presentation, the Board staff attorney presents arguments based the staff's evidence and responds to the assessee's arguments.

4. The assessee is given the opportunity to reply to the Board staff presentation.

5. If a witness is called, the assessee or the assessee's representative may ask questions of the witness without interruption, as long as the testimony is competent and relevant. When the assessee completes the examination of the witness, a Board Member (or, at the discretion of the Board Chair, the Board staff attorney), may examine the witness.

6. Finally, the Members may ask each party questions about the petition, the facts, or the law.

Admission of Evidence

For evidence, such as appraisal reports, financial studies, and other materials relevant to the value of the property, to be admitted, Board rules require that it be submitted to the Board with the petition.

The Board is not bound by the formal rules of evidence used in court. Board Members may admit all relevant evidence, including affidavits or hearsay, if it is the sort of evidence responsible persons rely upon in the conduct of serious affairs. While the Board follows a liberal standard for admission of evidence, the Board may exercise discretion when determining what weight to assign to evidence, considering any objections to its admission and/or comments on its weakness. The Board my refuse to admit evidence that it considers irrelevant, untrustworthy, or too repetitive.

Board Determination

All Board determinations are made at public hearings. If an oral hearing is held, the Board may take one of the following actions:

- order the matter to be taken under submission;
- decide the matter at the conclusion of the hearing day; or

- order the matter to be taken under submission, and allow the assessee and/or the Board staff more time to submit specific information.

Generally, petitions taken under submission by the Board, and those for which oral hearing has been waived, are put on a nonappearance agenda and voted on during a regularly scheduled Board meeting. If the petition is on the nonappearance agenda, the assessee normally will not be informed of the date of the Board meeting at which the matter will appear on the agenda.

When a decision is reached, the Board sends a written notice of decision, and, if requested in the petition, written findings and decision. The Board's decision is final. A petition will not be reconsidered or reheard.

FILING A CLAIM FOR REFUND

An assessee may file a claim for refund of tax to be paid or paid on a contested assessment or allocation. There are two different procedures, depending on whether the petition itself is intended to serve as a claim for refund.

Claim for refund made with original petition

As discussed above, the petition may also serve as a claim for refund, provided that the petition so states. If the Board denies the petition and, hence, the claim, then upon payment of tax to the county or counties, the assessee may proceed directly to file an action in superior court for a refund of the tax.

Subsequent claim for refund

If the Board denies a petition that does not also serve as a claim for refund, after the assessee has paid the tax, the assessee may file a written claim for refund with the county or counties where the property is located. The claim must be filed:

- within four years from the date of payment of the tax; or
- within one year from the mailing date of a notice or overpayment, whichever is later.

The claim for refund must state all of the reasons the assessee believes the assessment or allocation is incorrect. The county board of supervisors will consider the claim and mail its decision to the assessee. If the county rejects all or part of the claim for refund, or does not send a decision notice within six months of the date of the claim is filed, the assessee may proceed to file an action in superior court for a refund of the tax.

FILING AN ACTION IN SUPERIOR COURT

After the Board or the county has rejected a claim for refund (or has not sent a decision notice within six months of claim filing), the assessee has exhausted its administrative remedies and may bring an action in superior court for refund of the tax.

Board-denied claims

After the Board has denied a petition that also constitutes a claim for refund, and the assessee has paid the tax, the action must be filed within four years of

- the mailing of the Board's written decision on the petition; or
- the mailing date of the Board's written findings and conclusion on the petition, whichever is later.

County-denied claims

The action must be filed within six months from the date of the county board of supervisors' notice of action on the claim. If the county does not send a decision notice within six months of the date the claim is filed, the assessee may consider the claim denied and file an action in superior court.

AUDIT REVIEW AND ESCAPE ASSESSMENTS

AUDIT CONFERENCE

The Board periodically audits the records of state assessees to review information relating to the value of their property. If a disagreement over an audit conclusion arises during an audit, an assessee may attempt to resolve the dispute through discussion with the Board auditor and/or through the provision of more information in support of the assessee’s position.

After the audit, Valuation Division staff mail a copy of the preliminary audit report, and, if requested, copies of the audit work papers to the assessee. If the assessee disagrees with the conclusions of the report, he or she may request a meeting with the auditor and the auditor's supervisor. If, after discussion, the Board auditor is persuaded that any aspect of the audit is incorrect, he or she may revise the audit findings accordingly.

Following the meeting with the auditor and the auditor's supervisor, the Board mails the assessee a revised audit report setting forth any unresolved matters. Accompanying the revised report is a notice advising that the assessee has 30 days in which to present any new information or evidence to support the assessee’s position.

ESCAPE ASSESSMENT APPEALS

If the audit findings indicate that any property has escaped assessment or been underassessed, the Board's Valuation Division staff will recommend to the Board that an "escape assessment" for the property should be made. If the Board approves the escape assessment, at least 30 days prior to transmitting a statement of assessment of the escaped property, a “Notice of Escape Assessment” describing the escape assessment and advising of appeal rights is sent to the assessee. The process for appealing an escape assessment and filing a claim for refund is the same as that followed for contesting other Board assessments, as previously discussed.

SUMMARY OF APPEALS ACTIVITIES AND PERTINENT DATES AND/OR DEADLINES

Valuation Process

Action (by taxpayer, unless noted)	Date/deadline
File property statement	by March 1
Board holds public hearings	February and May
Board issues notice of value —Unitary properties	by June 1
Board issues notice of value — Nonunitary properties	by June 30
Assessment becomes final	within 20 days of mailing date of notice, if no declaration or petition is filed

Appeals of Assessments and Related Penalties

Action (by taxpayer, unless noted)	Date/deadline
Request copy of staff capitalization studies/calculations	
File declaration of intent	within 20 days of valuation notice mailing date
File petition for reassessment if no declaration of intent is filed	within 20 days of valuation notice mailing date
File petition for reassessment if a declaration of intent is filed	within 30 days after filing deadline for declaration
File claim for refund	with original petition, or with county within four years of payment of the tax
Board hearing and decision	by December 31 of the year in which the assessment is made.
File action in superior court	after Board denial of a petition and claim for refund, within four years of the mailing date of the Board's written decision on the petition or the mailing date of the Board's written findings and conclusion on the petition, whichever is later; or within 6 months after denial of a timely filed claim for refund or if after 6 months the board of supervisors has not taken action on claim for refund, an action may be filed at any time

Appeal of Allocated Assessment

Action (by taxpayer, unless noted)	Date/deadline
File petition for correction with Board	within 10 days after allocation notice
File claim for refund	with original petition, or with county within four years of payment of tax
Board hearing and decision	as specified in hearing notice, but by December 31 of the year in which the assessment is made
File action in superior court	after Board denial of a petition and claim for refund, within four years of the mailing date of the Board's written decision on the petition or the mailing date of the Board's written findings and conclusion on the petition, whichever is later; or within 6 months after denial of a timely filed claim for refund or if after 6 months the board of supervisors has not taken action on claim for refund, an action may be filed at any time

Contesting the Results of an Audit

Action (by taxpayer, unless noted)	Date/deadline
Let auditor know you disagree with conclusions	anytime during audit
Send letter detailing objections to auditor's supervisor	
Meet with auditor and auditor's supervisor	
Board sends revised audit report	
Submit new evidence	30 days, as specified in audit report
Board adopts and notices escape assessment for underassessed property	
File Petition appealing escape assessment	(See "Appeals of Assessments and Related Penalties.")

APPENDIX A: PRIVATE RAILROAD CAR TAX

The assessment of private railroad cars (PRRCs) differs from that of other public utility property, including railroad property, in significant respects. First, because of their mobility, most PRRCs are physically situated in California for only a portion of the year, and therefore must be assessed on a basis that considers this changing tax situs. Second, unlike other state-assessed property, the Board not only assesses PRRCs but also levies and collects the corresponding property tax, with the resulting tax revenues going to the state's General Fund rather than local government. This appendix reviews the statutory basis for Board's assessment of PRRCs, presents the method of assessment prescribed by law, and describes the Board's other duties relating to the private railroad car tax.

STATUTORY BASIS

Section 19 of article XIII provides the requirement that the Board assess private railroad car companies. Sections 11201 through 11702 of the Revenue and Taxation Code provide for the taxation of private railroad cars, prescribe the method of assessment, and generally define the Board's duties in regard to the Private Railroad Car Tax. Specifically, section 11251 provides that, "Private railroad cars operated upon railroads into, out of, or through this state shall be assessed and taxed by the board as prescribed in this part."

Section 11203 defines the private railroad cars subject to the tax. In general, these include any railroad rolling stock that is operated on railroads within the state, owned by an entity other than a railroad or the National Railroad Passenger Corporation, and intended to transport people, commodities, or materials.[50]

Railroad cars owned or leased by railroads are assessed as part of the railroad, as discussed earlier in this manual. Cars owned by the National Railroad Passenger Corporation (Amtrak) or the federal government are exempt from property taxation.

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[50] Certain railroad cars are specifically excluded from the tax. Section 11203 provides:

(b) "Private railroad car" does not include:

(1)Freight train or passenger train cars owned by railroad companies which are used or subject to use under the ordinary per diem agreement common to all railroads.

(2)Freight train or passenger cars handled under mileage or through line contract arrangements between railroad companies.

(3)Cars owned by or leased to any railroad company operating in this state, or by any railroad company operated as part of the same railroad system as the company operating in this state, and used by the railroad company in the operation, maintenance, construction, or reconstruction of its property and assessed and taxed in this state as a part of the property of a railroad company operating in this state.

(4)Passenger train cars, other than those described in subdivision (b), that are privately owned and for which the owner pays the railroad a fee, regardless of how calculated, for transporting such cars.

(5)Any railroad rolling stock for which a railroad or the National Railroad Passenger Corporation is the lessee. For a leased car, the car's Association of American Railroad's, or successor organization's reporting mark is rebuttably presumed to be the mark of the lessee.

Individual persons or companies that are not rail car companies may own passenger cars and pay the railroads fees to transport the cars. These are commonly known as “palace cars.” Such cars are not subject to state assessment; they are subject to local assessment to the extent they have tax situs in a county.

The Private Railroad Car Tax applies only to *rail cars*, not to tools, shop equipment, materials, any personal property typically used or kept at fixed locations to repair, improve, service, or operate the cars, or to any other railroad property.

ASSESSMENT

Rail cars often begin their route from a "terminal" state and travel through many "bridge" states before completing their trip in another terminal state. The cars deliver their cargo in a terminal state and typically remain there for a period of time while waiting for another load.

California law prescribes the car-day method of assessment. As described in section 11293, under this method, the average number of each class of rail car physically present in California in the calendar year preceding the fiscal year of the assessment is multiplied by the value of a rail car of that class to determine the assessment.

Railroad companies with interstate operations involving California measure rail car movement into and out of California and report this information to the Board, using car-type codes originally established by the Association of American Railroads and prescribed in section 11292. Board staff analyze this data to determine the number of days each class of car is in California.[51] The results are converted to an equivalent number of cars for each class of car; in other words, car-days are converted to car-years. The time that cars are not "qualified for revenue service," subject to specified limitations, is excluded from the number of car days in California.[52]

For example, if a company's class T cars (i.e., tank cars) were in California a total of 750 days, and the cars were not qualified for revenue service for 20 days, the equivalent number of cars of that class in California for the entire year is 2.0 ([750 days – 20 days]/365 days).

The estimated value of a rail car is based on its acquisition cost less depreciation, as prescribed in section 11292. Briefly, depreciation is calculated on a straight-line basis with a maximum of 80 percent depreciation allowed. Stack cars (class S), lightweight, low profile intermodal (class Q), flat cars (class F), conventional intermodal (class P), and vehicular flat (class V) use 22 years minus the age at acquisition for depreciable life. All other cars use 25 years minus the age at acquisition for depreciable life.

[51] Section 11316 provides for a 10 percent penalty of the value of the estimated or escaped assessment for any escape due to taxpayer negligence and a penalty of 25 percent of the value of the estimated or escaped assessment for any fraudulent or willful attempt to evade tax by the taxpayer.
[52] See section 11294.

To determine the assessment, or taxable value, the equivalent number of cars in California for each class of car is multiplied by the estimated value for each class of car.

LEVY AND COLLECTION OF TAX

As noted at the outset, the Board not only assesses private railroad cars but also levies and collects the corresponding property taxes. Under section 11401, the Board must levy a tax on private railroad cars on or before October 1 of each year. Under section 11404, on or before October 15th of each year, the Board must mail out a notice stating the amount of assessment, the rate and amount of tax, and a demand for payment of the tax to the Board no later than the following December 10.[53] As stated in section 11401, the Board calculates the tax rate for private railroad car assessments as the "next preceding year's" average rate of general property taxation in the state.[54]

DISPOSITION OF TAX PROCEEDS

Section 11701 prescribes that all revenues collected by the Board from the Private Railroad Car Tax be transmitted to the State Treasurer for deposit to the state treasury and credit to the state's General Fund. [55] As noted earlier, property taxes resulting from all other state assessments are levied and collected at the local level and are used to support local government.

[53] Section 11405 provides for a penalty of 10 percent of the tax plus interest on the amount of the tax at the adjusted rate pursuant to section 19521, from December 10th until the date of payment.

[54] The computation of the tax rate is prescribed in section 11403, which states: The board shall compute the average rate of general property taxation in the state by:

(a) Adding the county, city, school district, and other general taxes, but not the special taxes on intangibles, aircraft, baled cotton or any other property which is subject to a uniform statewide tax rate, nor special assessments, and

(b) Dividing the amount obtained by the total assessed valuation in the state as shown by the county tax rolls for the same year.

"Total assessed valuation" as used in this section, does not include the assessments of property which is subject to a uniform statewide tax rate.

"Special assessments," as used in this section, mean any amount levied solely against real estate or real estate and improvements.

[55] Pursuant to section 11702, upon warrant by the Controller, these monies shall be appropriated for any refunds that may be necessary.

APPENDIX B: PROPERTY TRANSACTIONS AND JURISDICTIONAL CHANGES

Various types of property transactions involving state and local assessees may produce changes in assessment jurisdiction—that is, from state-assessed to locally assessed, or vice versa. This appendix discusses jurisdiction in light of several typical property transactions.

GENERAL CONCEPTS

Several general concepts relating to jurisdiction constitute the background for resolving jurisdictional issues in specific situations. Many of these concepts were also discussed in Chapter 1.

(1) The Board's assessment jurisdiction is prescribed in section 19 of article XIII of the California Constitution:

> The Board shall annually assess (1) pipelines, flumes, canals, ditches, and aqueducts lying within 2 or more counties and (2) property, except franchises, owned or used by regulated railway, telegraph, or telephone companies, car companies operating on railways in the State, and companies transmitting or selling gas or electricity.

Constitutional mandate thus establishes two jurisdictional criteria: (1) a criterion based on the type of property and (2) a criterion based on the type of company.

The criterion based on type of property includes all property necessary for the operation of intercounty pipeline, flumes, canals, ditches and aqueducts Excluded from property meeting this criterion, however, are interests in land, ancillary delivery facilities, and personal property not directly related to the proper mechanical functioning of a pipeline, flume, canal, ditch, or aqueduct.

The criteria based on type of company includes all property owned or used by regulated railway, telegraph or telephone companies; rail car companies and companies that sell or transmit gas or electricity.

All taxable property that is not subject to state assessment by the Board is subject to local assessment by county assessors.

(2) Property subject to state assessment includes property that is *owned or used* by the state assessee. Thus, all property leased by a state assessee is subject to state assessment regardless of the lease term.

(3) While, there is no constitutional provision allowing the Board to delegate the assessment of property *owned* by a state assessee to local assessors, the Board may delegate the assessment of certain property *used* by state assessees. As stated in section 19 of article XIII:

> The Board may delegate to a local assessor the duty to assess a property *used but not owned* by a state assessee on which the taxes are to be paid by a local assessee. [Emphasis added.]

Thus, the Board may delegate the duty to assess property leased by a state assessee to the local assessor if a local assessee owns the property and the lease agreement provides that the local assessee-owner pays the property taxes.[56]

The Board's current practice is to delegate assessment duty in cases where the property is less than completely (i.e., 100 percent) leased by a state assessees and taxes are paid by a local assessee. If the Board delegates assessment duty to a local assessor, the property becomes subject to the assessment provisions of article XIII A.

There is a qualification that involves leasehold improvements, however. When delegating assessment duty, the Board retains assessment jurisdiction over fixtures items installed by the state assessee. The assessment of structural items is typically delegated to the local assessor together with the land and all other improvements.

(4) Since locally assessed property generally is assessed under the provisions of article XIII A of the California Constitution while state-assessed property is not, when the assessment jurisdiction of a property changes, the method of assessment also changes. For example, if a state-assessed property becomes locally assessed, it should be assessed as all other locally assessed property, and vice versa.

(5) Generally, property transactions between a state assessee and another state assessee or between a local assessee and another local assessee have no effect on assessment jurisdiction. For example, if one state assessee sells property to another state assessee, generally no assessment action is required by the local assessor.

SOME TYPICAL SITUATIONS

SALE OF PROPERTY FROM LOCAL ASSESSEE TO STATE ASSESSEE

Property purchased by a state assessee from a local assessee is subject to Board assessment jurisdiction as of the date of transfer. The local assessor should notify the Board of the transfer and remove the property from the local assessment roll. The Board will assess the property on the next lien date, in accord with subdivision (b) of section 722.5:

> [R]eal property that becomes subject to board assessment on or after January 1, and on or before the following January 1, shall not be state assessed until the assessment year commencing on the latter January 1.

[56] Assessment duty cannot be delegated by the Board to a local assessor, if property taxes are simply passed through by the property owner to the state assessee. In such cases, however, it may be possible to amend lease agreement in a manner that allows the delegation of assessment duty to the local assessor.

The property comes under state jurisdiction on the date of the transfer even though it will not be assessed by the Board until the ensuing January 1. Since it is under state jurisdiction, neither the change in ownership nor any subsequent new construction is subject to supplemental assessment.

SALE OF PROPERTY FROM STATE ASSESSEE TO LOCAL ASSESSEE

Property purchased by a local assessee from a state assessee is subject to local assessment jurisdiction, and therefore subject to the provisions of article XIII A, as of the date of change in ownership. The property is subject to supplemental assessment by the county assessor. Subdivision (a) of section 722.5 contains specific reference to supplemental assessment provisions (sections 75 and following):

> Real property assessed by the board … which thereafter becomes subject to local assessment, shall not be assessed locally during the remainder of the assessment year, except as provided in Chapter 3.5 (commencing with Section 75) of Part 0.5 of Division 1.

The amount of the supplemental assessment is the difference between the property's new base year value as established by the county assessor and the taxable value on the current board roll. The taxable value on the current board roll is the portion of the state-assessed value allocable to the subject property. As stated in section 75.9:

> In the case of real property which, prior to the date of the change in ownership or completion of new construction, was assessed by the board pursuant to Section 19 of Article XIII of the California Constitution, ''taxable value'' means that portion of the state-assessed value determined by the board to be properly allocable to the property which is subject to the supplemental assessment.

Contact between the county and the Board's Valuation Division is necessary to determine the allocated value.

SALE AND LEASEBACK BY STATE ASSESSEE

In a typical sale-leaseback transaction, the sale and leaseback are essentially simultaneous. In a sale-leaseback involving a state assessee, the state assessee owner-seller, immediately becomes the lessee. There is generally no change in assessment jurisdiction, since all property owned or *used* (i.e., leased) by a state assessee is subject to state assessment. The property remains state assessed, unless the agreement specifies that not all of the property is leased to the state assessee, and the purchaser/lessor is to pay the property taxes.

PROPERTY OWNED BY LOCAL ASSESSEE AND LEASED TO STATE ASSESSEE WITH SALE OF LESSOR'S INTEREST

A change in ownership of the underlying fee interest (i.e., the lessor's interest) in a local assessee-owned but state-assessed property (i.e., the property is leased to a state assessee) does not change the assessment jurisdiction. Since the property remains leased to a state assessee it remains under Board jurisdiction.

No action should be taken by the county assessor. The is true even if the remaining term of the lease is less than 35 years; in which case, if the property were under local assessment jurisdiction, there would be a change in ownership. However, because the property remains under state assessment jurisdiction, it is not subject to the change in ownership provisions of article XIII A.

PROPERTY OWNED BY A LOCAL ASSESSEE AND LEASED TO STATE ASSESSEE WITH LEASE TERMINATION

In this scenario, assessment jurisdiction changes from state to local as of the date of lease termination because after that point in time a state assessee neither owns or uses the property. As locally assessed, the property becomes subject to article XIII A.

If the lease was for an original term of 35 years or more, the termination of the lease is a change in ownership, and the county assessor should reassess the property and establish a new base year value. The assessor should also issue a supplemental assessment. (Since the property is owned by a local assessee, the property was previously assessed on the local roll and hence a base year value for the property should exist. The base year value of the property should be revised, if necessary, to reflect any incremental base year value(s) resulting from new construction while the property was subject to state assessment. If the improvement was constructed and immediately occupied by the state assessee—for example, under a ground lease arrangement—a base year value for the improvement will not exist. The assessor should determine what the base year value of the improvements would have been as of the date of their completion.

If the lease was for an original term of less that 35 years, there is no change in ownership and hence no reassessment or supplemental assessment. For the lien date following lease termination, the county assessor should enroll a taxable value consistent with the provisions of article XIII A. Normally, this would be the lesser of the property's factored base year value or current market value, as prescribed in subdivision (a) of section 51

FOREIGN IMPROVEMENTS

For the purpose here, improvements owned by one party that are located on land owned by another party are called "foreign improvements" (in other contexts they might also be referred to as leasehold improvements or tenant improvements). If owned by a local assessee, and not leased to a state assessee, foreign improvements on state-assessed land are subject to local assessment jurisdiction. The local assessor should assess such foreign improvements as any other property in the assessor's jurisdiction—under the provisions of article XIII A.

In the case of foreign improvements owned by a state assessee and land owned by a local assessee, both land and improvements are state-assessed—the improvements because they are owned by a state assessee and the land because it is undoubtedly leased by the state assessee.

LESSOR'S EXEMPTION CLAIMS

If a lessor's exemption is sought for state-assessed property, the property owner must file a lessor's exemption claim form with the local assessor where the property is located. The Board has no authority to grant the exemption; this power rests with county assessors. The assessor

receiving an exemption claim involving state-assessed property should act on the claim in the same manner as a claim for locally assessed property. After the claim is processed, the assessor should forward a copy of the claim form with advice of the assessor's determination to the Board's Valuation Division.

DISCOVERY OF STATE ASSESSED PROPERTY

The Board's discovery of state-assessed property is largely through taxpayer reporting. A state assessee is required to file an annual property statement detailing, among other things, all property owned or used, except licensed motor vehicles, as of the lien date.

County assessors' offices may discover property under state jurisdiction as part of their normal assessment duties (e.g., the processing of changes in ownership, memoranda of leases, and building permits). When an assessor discovers that a state assessee has acquired or leased locally assessed property, or obtained a building permit relating to locally assessed property, the assessor should notify the Board's Valuation Division. If the Board determines that it has assessment jurisdiction, the Valuation Division will notify the local assessor via a "List of Land Changes". The Board will also send new land identification maps to the assessor identifying the property with a Board ("SBE") parcel number.

STATE BOARD OF EQUALIZATION MAPS AND PARCEL NUMBERS

The Board sends land identification maps ("Board maps") to local assessors when there is a change in assessment jurisdiction. The maps describe the property involved with respect to officially established survey lines, corners, or other reference points shown on maps of record. The Board's parcel numbers ("SBE parcel numbers") are quite different from the parcel numbers ("APNs") assigned by local assessors. The numbers derive from completely distinct mapping systems.

Each parcel of land owned or used by a state assessee is assigned a unique parcel number. Each SBE parcel number has four groups of characters—for example, 872-27-16D-1A.

1. The first group of characters is a unique number assigned to each state assessee. In this example, "872" represents Southern Pacific Railroad Company. Assessees are numerically grouped by industry as follows:

Industry	SBE Number		
Gas, Electric, Water and Gas Transmission	100	—	199
Local Exchange Telephone Companies	200	—	399
Pipeline Companies	400	—	499
Railcar Maintenance Facilities	500	—	699
Railroad Companies	800	—	899
Long Distance Telephone Companies	2000	—	2499
Wireless Telephone Companies	2500	—	2599
Radio Common Carrier Companies	3000	—	3999
Long Distance Telephone Companies	7500	—	7999
Wireless Telephone Companies	D001	—	D999
Long Distance Telephone Companies	P001	—	P999

2. The second group of characters is a unique code for each county. In the example, "27" represents Monterey County. County numbers are as follows:

County Number	County Name	County Number	County Name
1	Alameda	30	Orange
2	Alpine	31	Placer
3	Amador	32	Plumas
4	Butte	33	Riverside
5	Calaveras	34	Sacramento
6	Colusa	35	San Benito
7	Contra Costa	36	San Bernardino
8	Del Norte	37	San Diego
9	El Dorado	38	San Francisco
10	Fresno	39	San Joaquin
11	Glenn	40	San Luis Obispo
12	Humboldt	41	San Mateo
13	Imperial	42	Santa Barbara
14	Inyo	43	Santa Clara
15	Kern	44	Santa Cruz
16	Kings	45	Shasta
17	Lake	46	Sierra
18	Lassen	47	Siskiyou
19	Los Angeles	48	Solano
20	Madera	49	Sonoma
21	Marin	50	Stanislaus
22	Mariposa	51	Sutter
23	Mendocino	52	Tehama
24	Merced	53	Trinity
25	Modoc	54	Tulare
26	Mono	55	Tuolumne
27	Monterey	56	Ventura
28	Napa	57	Yolo
29	Nevada	58	Yuba

3. The third group of characters identifies the map and its position in a series. This group consists of from 1 to 3 characters. In the example, "16" indicates that the map is the 16th in a series of maps for that county. Each map change from the original map filed is noted by an alphabetical suffix, "A","B","C", etc. In the example, "16A" indicates that this map is a supplementary map that has been filed. With each map revision the specific parcels will be renumbered starting from 1.

4. The fourth part of a SBE parcel number identifies a specific parcel. This group consists of from 1 to 3 characters. A change to a specific parcel is noted by an alphabetical suffix. In the example, "1A" indicates that there has been revised once.

State assessed property that transfers from one state assessee to another does not receive a new SBE parcel number. Instead, SBE parcel numbers are listed following the new owner’s company number. For example, the state assessee number for Union Pacific Railroad Company that is “843”. If the example property were acquired by Union Pacific Railroad Company, the property would simply be listed under 843, and the new SBE parcel number would be 843-872-27-16D-1A

APPENDIX C: BOARD PROPERTY CLASSIFICATION CODES

The Board classifies property reported by an assessee by classification code. The following tables contain the classification codes for various types of unitary and nonunitary property.

Unitary

Code	*Description*
001	Operating Property – Land
002	Operating Property – Improvements
003	Operating Property – Personal Property
011	Possessory Interest – Land
012	Possessory interest – Improvements
021	Miscellaneous Other Rights - Land
022	Miscellaneous Other Rights - Improvements
023	Miscellaneous Other Rights - Personal Property
041	Leased Land
042	Leased Improvements
043	Leased Personal Property
071	Property Which is to Show Separately on the Roll for any Reason Except as Indicated Above - Land
072	Property Which is to Show Separately on the Roll for any Reason Except as Indicated Above - Improvements
073	Property Which is to Show Separately on the Roll for any Reason Except as Indicated Above - Personal Property
083	Aircraft
101	Hannigan Unitary Land (not 000-001)
102	Hannigan Unitary Improvements (not 000-001)
103	Hannigan Unitary Personal Property (not 000-001)
221	Fiberoptic R/W
401	Unitary Timber Preserve Zone Land
421	Gas Transmission R/W

Nonunitary

Code	*Description*
051	Leased Property to be Assessed to Non-utility Owner - Land
052	Leased Property to be Assessed to Non-utility Owner - Improvements
053	Leased Property to be Assessed to Non-utility Owner - Personal Property
061	Property Exempt From Taxation Under Section 3 of Article XIII of the Constitution - Land
062	Property Exempt From Taxation Under Section 3 of Article XIII of the Constitution - Improvements
091	Non-operating – Land
092	Non-operating – Improvements
093	Non-operating – Personal Property
191	Operating Nonunitary - Land
192	Operating Nonunitary - Improvements
193	Operating Nonunitary - Personal Property
491	Nonunitary Timber Preserve Zone Land
891	Nonunitary Railroad Transportation Property - Land
892	Nonunitary Railroad Transportation Property - Improvements
893	Nonunitary Railroad Transportation Property - Personal Property

Property Classification Summary Table

Property Group	*Land*	*Imps*	*PP*
Operating Property	001	002	003
Possessory Interest	011	012	
Miscellaneous Other Rights	021	022	023
Leased	041	042	043
Exempt Property	061	062	
Aircraft			083
Property Shown Separately on the Roll	071	072	073
Non-Operating Nonunitary	091	092	093
Hannigan Unitary Property	101	102	103
Operating Nonunitary	191	192	193
Fiber Optic Right of way	221		
Unitary TPZ Land	401		
Gas Transmission Right of Way	421		
Nonunitary TPZ Land	491		
Nonunitary Rail Transportation Property	891	892	893

APPENDIX D: STATE ASSESSMENT CALENDAR

DATE	PARTY	ACTIVITY	AUTHORITY
January 1	State assessees	State-assessed property shall be assessed at its fair market or full value as of 12:01 a.m. on the first day of January.	§ 722. Rev. & Tax. Code
No later than January 30	Executive Director	The Executive Director shall provide the Board with a proposed schedule of dates that will govern the actions to be taken pursuant to Rule 902. (Unitary Property Value Indicators and Staff Discussions), Rule 903. (Discussion with Board of Unitary Property Value Indicators), and Rule 904. (Unitary and Nonunitary Property Value Determinations and Petitions for Reassessment) no later than November 30 each year. Upon Board approval, but no later than January 30 of the next year, the Executive Director shall inform all state assessees of the schedule adopted by the Board.	Rule 901.5 Property Tax Rules
Between the first day of January and the first day of June	Board	The Board shall mail notice to the assessee stating the amount of the assessed value of the assessee's unitary property. The Board shall also notify state assessees of the date for filing a declaration of intent to petition for reassessment not less than 20 days from the date of mailing the value notice and petition for reassessment not less than 30 days after the date established for the declaration of intent. The Board may extend the petition filing period once for a period not to exceed 15 days, provided a written request for the extension is filed prior to the expiration of the period for which the extension may be granted.	§ 731. & § 733. Rev. & Tax. Code
Between the first day of January and the last day of June	Board	The Board shall mail notice to the assessee stating the amount of the assessed value of the assessee's nonunitary property. The Board shall also notify state assessees of the date for filing a declaration of intent to petition for reassessment not less than 20 days from the date of mailing the value notice and petition for reassessment not less than 30 days after the date established for the declaration of intent. The Board may extend petition filing period once for a period not to exceed 15 days, provided a written request for the extension is filed prior to the expiration of the period for which the extension may be granted.	§ 732. & § 733. Rev. & Tax. Code
March 1	State assessees	Last day to file property statements with the Board for requests mailed on or before January 1. Assessees have 60 days from mailing date of requests mailed after January 1 to file property statements. Rule 901 provides that the Board may grant an extension for cause not to exceed 30 days	§ 830. & § 830.1 Rev. & Tax. Code Rule 901. Property Tax Rules
On or before April 30	Private railroad cars	The annual report required by § 11271 of the Revenue & Taxation Code of all persons whose private railroad cars operated upon the railroads of this State at any time during the prior calendar year shall be filed on or before April 30.	§ 11271. Rev. & Tax. Code Rule 1001. Property Tax Rules
May 30	Any subscriber to the board's tax rate area change service	Any subscriber to the Board's tax rate area change service and who receives a change mailed between April 1 and May 1, shall file a corrected statement no later than May 30. If change mailed after May 1, a corrected statement shall be filed no later than the 60th day following the mailing of	§ 830.(d) Rev. & Tax. Code

DATE	PARTY	ACTIVITY	AUTHORITY
		change.	
No later than May 31	Board	The Board will make and publicly announce individual unitary-value determinations no later than May 31. The Chief of the Valuation Division shall notify the state assessees of the values determined by the Board and the fact that they have 20 days from the date of mailing of the value notice in which to file a declaration of intent to petition for reassessment, and 30 days thereafter to file a petition for reassessment. A copy of an appraisal data sheet containing the staff value indicators and value recommendations to the Board shall accompany the notice.	Rule 904.(a) Property Tax Rules
On or before the last day of June	Chief, Valuation Division	The Chief of the Valuation Division of the State Board of Equalization shall notify the state assessees of the values of nonunitary property. Notice will also inform state assessees that they have 20 days from date of mailing of value notice in which to file declaration of intent to petition for reassessment, and 30 days thereafter to file a petition for reassessment.	Rule 904.(b) Property Tax Rules
Prior to the last day of June	Board	Board shall notify the proposed allocation of assessed unitary values to the assessees. Notice will also inform state assessees that they have 5 days from the date of mailing of the notice in which to petition the Board for correction of an allocated value.	§ 746. Rev. & Tax. Code
On or before the last day of June	Chief, Valuation Division	The Chief of the Valuation Division of the State Board of Equalization shall notify state assessees of the allocated assessed unitary values of each assessee. Notice will also inform state assessees that they have10 days from the date of mailing the notice in which to file a petition for reallocation of unitary values and that the petitions will be set for hearing and decisions rendered no later than July 31.	Rule 904.(c) Property Tax Rules
On or before July 15	Board	Board shall transmit estimates of total assessed values of state assessed property to county auditors.	§ 755. Rev. & Tax. Code
Prior to July 31	Board	Notify petitioners of its decisions on petitions for corrections of allocated assessments.	§ 749. Rev. & Tax. Code
On or before July 31	Board	Transmit changes to estimates of total assessed values of state-assessed property to county auditor.	§ 755. Rev. & Tax. Code
On or before July 31	Board	Board adopts assessment rolls. Staff transmits assessment rolls to county auditors. Roll is open to inspection by interested agencies and districts.	§ 756. Rev. & Tax. Code
December 31	Board	Last day to complete decisions on petitions for reassessment of unitary and nonunitary values	§ 744. Rev. & Tax. Code

1

APPENDIX E: CONSTITUTIONAL PROVISIONS, STATUTES, REGULATIONS, AND SIGNIFICANT CASES[57]

CONSTITUTIONAL PROVISIONS

Article XIII, section 14.

Property to be assessed where situated. All property taxed by local government shall be assessed in the county, city, and district in which it is situated.

Article XIII, section 19.

State board to assess and tax property of public utilities. The Board shall annually assess (1) pipelines, flumes, canals, ditches, and aqueducts lying within 2 or more counties and (2) property, except franchises, owned or used by regulated railway, telegraph, or telephone companies, car companies operating on railways in the State, and companies transmitting or selling gas or electricity. This property shall be subject to taxation to the same extent and in the same manner as other property.

No other tax or license charge may be imposed on these companies which differs from that imposed on mercantile, manufacturing, and other business corporations. This restriction does not release a utility company from payments agreed on or required by law for a special privilege or franchise granted by a government body.

The Legislature may authorize Board assessment of property owned or used by other public utilities.

The Board may delegate to a local assessor the duty to assess a property used but not owned by a state assessee on which the taxes are to be paid by a local assessee.

STATUTES

REVENUE AND TAXATION CODE PROVISIONS

Section 108

"State assessed property." "State-assessed property" means all property required to be assessed by the board under Section 19 of Article XIII of the Constitution and which is subject to local taxation.

[57] The information in this appendix was current as of the publication date. The information may not reflect current law.

Section 721

Valuation and assessment. The board shall annually value and assess all of the taxable property within the state that is to be assessed by it pursuant to Section 19 of Article XIII of the Constitution and any legislative authorization thereunder.

Section 722

Ratio of assessed to full value. State-assessed property shall be assessed at its fair market value or full value as of 12:01 a.m. on the first day of January. The board shall annually prepare an assessment roll of the assessments made by it for transmittal to county auditors and city auditors as hereinafter provided in this chapter.

Section 722.5

Local and State assessment dates. (a) Real property assessed by the board pursuant to Section 19 of Article XIII of the California Constitution on January 1, which thereafter becomes subject to local assessment, shall not be assessed locally during the remainder of the assessment year, except as provided in Chapter 3.5 (commencing with Section 75) of Part 0.5 of Division 1.

(b) Personal property that becomes subject to board assessment after January 1, and real property that becomes subject to board assessment on or after January 1, and on or before the following January 1, shall not be state assessed until the assessment year commencing on the latter January 1.

Section 723

Use of principle of unit valuation. The board may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in a primary function of the assessee. When so valued, those properties are known as "unitary property." Property of an assessee not valued through the use of the principle of unit valuation are known as "nonunitary property." When valuing nonunitary property, the board shall consider current market value information of comparable properties provided by the assessor just prior to the reappraisal by the board of that property.

Section 723.1

Operating nonunitary properties. Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee. This section does not apply to state-assessed property of regulated railway companies. In the case of regulated railway companies, there shall be only two classifications of property for purposes of this code, unitary and nonunitary.

Section 724

Timely performance. Whenever any act is required or allowed to be done on or before a date specified in this chapter and that day is a Saturday, Sunday or holiday, the act may be performed timely during the next following business day.

Section 725

Validity of assessment or taxes. The failure to receive any notice required to be given by the board or the failure of the board to complete any action by a date specified under this chapter, shall not affect the validity of an assessment or the validity of any taxes levied pursuant thereto. When any notice given by the board pursuant to this chapter provides for a time period of less than 10 days, the notice shall also be communicated by telephone on the day the notice is dated.

Section 731

Notification of assessment; unitary value. Each year between the first day of January and the first day of June, upon valuing the unitary property of an assessee, the board shall mail to the assessee, at its address as shown in the records of the board, a notice stating the amount of the assessed value of the assessee's unitary property. The notice shall advise the assessee of the date by which and the place where a declaration of intent for reassessment of the unitary property may be filed. The date for filling of the declaration of intent shall not be less than 20 days from the date of the mailing of the notice of value and the date for filing the petition shall not be less than 30 days from the date set for filing the declaration of intent to petition.

Section 732

Notification of assessment; nonunitary property. Each year between the first day of January and the last day of June, upon valuing the nonunitary property of an assessee, the board shall mail to the assessee at its address shown in the records of the board a notice stating the amount of the assessed value of the assessee's nonunitary property. The notice shall advise the assessee of the date by which and the place where a declaration of intent to petition for reassessment, and the date by which and place where a petition for reassessment of the nonunitary property may be filed. The date for filing of the declaration of intent shall not be less than 20 days from the date of the mailing of the notice of value and the date for filing the petition shall not be less than 30 days from the date set for filing of the declaration of intent to petition.

Section 733

Finality of assessment. If the assessee fails to file a declaration of intent to file a petition for reassessment within the period specified in the notice mailed by the board in accordance with Section 731 or Section 732, an assessment of unitary or nonunitary property of the assessee shall become final at the expiration of the period specified. If the assessee files a petition for reassessment within the period specified for filing a declaration of intent to petition, no declaration of intent needed be filed.

If, after a declaration if intent to file a petition has been timely filed, a timely petition for reassessment is not filed with the board, an assessment of unitary or nonunitary property of an assessee shall become final at the expiration of the period specified for filing a petition in the notice given in accordance with Section 731 or Section 732.

The board may extend the period for filing a petition for reassessment once for a period not to exceed 15 days, provided a written request for the extension is filed with the board prior to the expiration of the period for which the extension may be granted.

Section 741

Petition for reassessment. A petition for reassessment of unitary or nonunitary property shall be in writing and shall state the specific grounds upon which it is claimed a correction or adjustment of the assessment is founded. The petition shall be delivered to the board at its headquarters office in Sacramento.

Section 742

Hearing on petition for reassessment. Upon receipt of a timely petition for reassessment, the board shall set a time and place within the state for hearing on the petition. Notice thereof shall be mailed to the assessee at its address as shown in the records of the board, not less than 10 working days in advance of the date of the hearing.

Section 743

Continuance of hearing; record; transcript. The hearing may be continued by the board for good cause. The hearing shall be open to the public, except that upon conclusion of the taking of evidence the board may deliberate in private with the aid of its staff in reaching a conclusion. Upon written request, the board shall make a full record of the hearing and furnish the petitioner with a transcript thereof at the petitioner's expense.

Section 744

Notification of decision; findings and conclusions. (a) The board shall notify the petitioner of its decision on a petition for reassessment by mail and shall make written findings and conclusions in requested at or prior to the commencement of the hearing. The board shall send a periodic report of its decisions and any written findings and conclusions thereon to each county in which affected state-assessed property is situated. The findings shall fairly disclose the board's determination of material factual issues and shall contain a statement of the method or methods of valuation used by the board in valuing the property. Notwithstanding the requirement for a statement of method or methods, the board's approval of a settlement of a lawsuit contesting the value of state-assessed property shall be sufficient disclosure when value is determined in accordance with a board-approved settlement. Decisions of the board on petitions for reassessment of state-assessed property shall be completed on or before December 31.

(b) When the value of an assessee's state-assessed property is determined, after a hearing on a petition for reassessment, to be different from the value originally adopted by the board, the board shall determine the year in which the corrected value is to be entered on the roll. The correct value may be entered on the roll for the fiscal in which the determination is made, or the difference between the original and the corrected value may be entered as an increase or decrease in the assessment for the succeeding fiscal year. If the corrected value is entered on the roll for the fiscal year in which it is determined, and the board roll has been transmitted to the county

auditors, the board shall make the corresponding changes in allocations and transmit the roll corrections to the county auditor.

(c) If the amount of the correction is to be entered on the roll for the succeeding fiscal year, an amount is to be added in lieu of interest. If the correction results in a reduction in assessed value, there shall be added to the reduction, in lieu of interest, 9 percent of the difference between the original assessed value, there shall be added to the increase, in lieu of interest, 9 percent of the difference between the original assessed value and the increased assessed value.

Section 745

Assessment; placement on roll. The assessment of the unitary and operating nonunitary property of an assessee shall be allocated to assessments on the roll prepared by the board among the counties in which parts of the unitary and operating nonunitary property are situated. The assessment of the nonunitary property of an assessee shall be placed on the assessment roll prepared by the board.

Section 746

Notification of proposed allocated assessed values of unitary property. Upon or prior to the completion of the assessment roll prepared by the board, the board shall mail notice to each assessee at its address as shown on the records of the board, of the allocated assessed values of the assessee's unitary property that have been or are proposed to be placed on the assessment roll to be transmitted to county auditors. The notice shall include a statement of the date by which and the place where the assessee may petition for a correction of an allocated assessment. The date shall not be less than five days from the date of mailing of the notice. The time and place for hearing, in the event a petition is to be filed, may be stated in the notice, and in that case the time for the hearing shall not be less than 10 days from the date of the mailing of the notice of the allocated assessed values.

Section 747

Petition for correction of allocated assessment. A petition for correction of an allocated assessment shall be in writing and state the specific grounds upon which it is claimed a correction or adjustment in the allocation is founded. The value of the total unitary property of an assessee may not be brought into issue in a petition for correction of an allocated assessment.

Section 748

Hearing on petition for correction of allocated assessment. Upon receipt of a timely petition for correction of an allocated assessment, the board shall set a time and place within the state for hearing, if it has not done so in the notice given under Section 746, and shall mail notice to the assessee of the time and place of the hearing at its address as shown on the records of the board. The time for the hearing shall not be less than five days from the date of mailing of the notice.

Section 749

Record; transcript. Section 743 shall be applicable to hearings on petitions for correction of an allocated assessment and the board shall notify the petitioner of its decision by mail prior to July 31. The decision shall include written findings and conclusions of the board if requested at or prior to the commencement of the hearing.

Section 755

Transmission of estimates of total assessed values to county auditors. (a) On or before July 15, the board shall transmit to each county auditor an estimate of the total unitary value and operating nonunitary value of state-assessed property in the county and of nonunitary state-assessed property in each revenue district in the county. An estimate need not be made for a revenue district that did not levy a tax or assessment during the preceding year unless the board receives on or before January 1 preceding the fiscal year for which the levy is to be made a notice in writing of the proposed levy. The estimate shall be regarded as establishing the total assessed value of state-assessed property in the county and each revenue district in the county for the purpose of determining tax rates, subject only to such changes as may be transmitted on or prior to July 31. All information furnished pursuant to this section is at all times during office hours open to inspection of any interested person or entity.

(b) Notwithstanding subdivision (a), in making the estimate referred to in subdivision (a), the unitary value and nonunitary value of the property of regulated railway companies and property subject to subdivision (I) of Section 98.9 shall be allocated by revenue district.

Section 756

Transmission of rolls to county auditor. (a) On or before July 31, the board shall transmit to each county auditor a roll showing the unitary and operating nonunitary assessments made by the board in the county and the nonoperating nonunitary assessments made by the board in each city and revenue district in the county; provided, however, that the roll need not show the assessments made by the board in a revenue district which did not levy a tax or assessment during the preceding year. Such roll is at all times, during office hours, open to the inspection of any person representing any taxing agency or revenue district, or any district described in Section 2131. If the roll does no show the assessments in a revenue district as herein provided and a notice of a proposed levy is furnished the board in writing, on or before January 1 preceding the fiscal year for which the levy is to be made, the board shall furnish an estimate of the total assessed value of nonoperating nonunitary state-assessed property in the district and shall transmit thereafter to the county auditor a statement of roll change showing the nonoperating nonunitary assessments made by the board in the district.

(b) Notwithstanding subdivision (a), in making the roll referred to in subdivision (a), the unitary value and nonunitary value of the property of regulated railway companies and property subject to subdivision (I) of Section 98.9 shall be enrolled by revenue district.

Section 11203

"Private railroad car." (a) "Private railroad car" includes any railroad rolling stock intended for the transportation of any persons, commodity, or material, operated on the railroads of this state, which car is owned by a person other than a railroad or the National Railroad Passenger Corporation. The car's Association of American Railroad's, or successor organization's, reporting mark shall be rebuttably presumed to be the mark of the car owner.

(b) "Private railroad car" does not include:

(1) Freight train or passenger train cars owned by railroad companies which are used or subject to use under the ordinary per diem agreement common to all railroads.

(2) Freight train or passenger cars handled under mileage or through line contract arrangements between railroad companies.

(3) Cars owned by or leased to any railroad company operating in this state, or by any railroad company operated as a part of the same railroad system as the company operating in this state, and used by the railroad company in the operation, maintenance, construction, or reconstruction of its property and assessed and taxed in this state as a part of the property of a railroad company operating in this state.

(4) Passenger train cars, other than those described in subdivision (b), that are privately owned and for which the owner pays the railroad a fee, regardless of how calculated, for transporting such cars.

(5) Any railroad rolling stock for which a railroad or the National Railroad Passenger Corporation is the lessee. For a leased car, the car's Association of American Railroad's, or successor organization's reporting mark is rebuttably presumed to be the mark of the lessee.

Section 11206

"Class of private railroad cars." "Class of private railroad cars" means the Association of American Railroad's, or successor organization's, one letter alpha component of its car type codes as contained in that organization's Exhibit D of the UMLER specification manual or successor exhibit.

Section 11251

Assessment of cars. Private railroad cars operated upon railroads into, out of, or through this state shall be assessed and taxed by the board as prescribed in this part.

Section 11291

Property included in value of cars. The value of private railroad cars shall not include the car owner's tools, shop equipment, materials, supplies, or other like items of personal property customarily kept or maintained at fixed locations for use in repairing, improving, servicing, or operating the cars.

Section 11292

Depreciable life. In making the assessment, the board shall value the cars by class based on the owner's acquisition cost, less depreciation. The depreciation shall be computed for these enumerated Association of American Railroad's, or successor organization's, car type groups on a straight-line basis with the indicated depreciable life schedules with a maximum of 80 percent depreciation allowed.

(a) Stack cars (alpha S): 22 years minus the age at acquisition.

(b) Lightweight, low profile intermodal cars (alpha Q): 22 years minus the age at acquisition.

(c) Flat cars (alpha F): 22 years minus the age at acquisition.

(d) Conventional intermodal cars (alpha P): 22 years minus the age at acquisition.

(e) Vehicular flat cars (alpha V): 22 years minus the age of acquisition.

(f) All other cars (all other alphas): 25 years minus the age at acquisition.

(g) Betterments: the remaining depreciable life of the car to which the betterment is applied.

Acquisition cost is defined as the expenditures required to be capitalized by generally accepted accounting principles.

Section 11293

Amount of cars. In making an assessment the board shall determine the average number of each class of private railroad cars physically present in the state in the calendar year immediately preceding the fiscal year in which the tax is imposed upon the basis of car days. The board shall multiply the average number so determined by the value of a car of that class as determined under Section 11292 and use the product for the assessment of the cars.

Section 11294

Amount of cars; exclusion. In determining the averages required in Section 11293, the board shall exclude from the California factor car mileage, car days or such other data which occurs while cars are not qualified for revenue service and are in a repair facility in this state requiring and undergoing or awaiting remodeling, overhaul, renovation, conversion or repair which necessitates total labor in excess of 10 man-hours.

Car days excluded pursuant to this section shall not exceed 90 days per car unless the claimant provides substantiation of the necessity for the additional days in such form as prescribed by the board.

PROPERTY TAX RULES

TITLE 18, PUBLIC REVENUES, CALIFORNIA CODE OF REGULATIONS

Rule 901. Property Statement

References: Section 826, Revenue and Taxation Code.

Section 15620, Government Code.

The property statement pertaining to state-assessed property provided for in section 826 of the Revenue and Taxation Code shall be filled with board between the lien date and 5 p.m. on March 1; provided that, on a showing of good cause and pursuant to a request made prior to March 1, the due date may be extended by the board for a period not exceeding 30 days.

Rule 901.5. Board Schedule

Reference: Sections 731, 732, 741, 742, 743, 747, 748, 749, 11338, 11339, 11353, Revenue and Taxation Code.

No later than November 30 each year the Executive Director shall provide to the Board a proposed schedule of dates that will govern the actions to be taken pursuant to sections 902 through 905 for the following calendar year. On Board approval, but no later than January 30 next following, the Executive Director shall inform all state assessees of the schedule adopted by the Board.

Rule 902. Unitary Property Value indicators and Staff Discussions

Reference: Section 721, 722, 723, 724, 725, Revenue and Taxation Code.

Each year the Valuation Division shall make capitalization rate studies and develop value indicators applicable tot he unitary property of each state assessee. A copy of the appropriate capitalization rate study and a summary of the calculations of the value indicators shall be provided by the Chief, Valuation Division, to the affected assessee on request. The assessee shall be informed that the staff will be available to discuss the data supplied.

Rule 903. Discussion with Board of Unitary Property value Indicators

Reference: Sections 721, 722, 723, 724, 725, Revenue and Taxation Code.

State assessees will, at the discretion of the Board, be afforded an opportunity to discuss the value of their unitary property at a public meeting. The discussion may relate to any information bearing on the value of the property as well as the staff-calculated value indicators. For the purposes of this discussion, the staff will not be required to provide value recommendations.

Rule 904. Unitary and Nonunitary Property Value Determinations and Petitions for Reassessment

Reference: Sections 721, 731, 732, 746, 749, 756, Revenue and Taxation Code.

(a) As soon as practical, the staff shall transmit unitary-value recommendations to the Board. Following this, but not later than May 31 each year, the Board will make and publicly announce individual value determinations. The Chief of the Valuation Division shall notify the state assessees of the values determined by the Board and the fact that they have 20 days from the date of the mailing of the notice to file their declaration of intent to petition for reassessment. The notice will also inform each assessee that if a declaration of intent is timely filed, the assessee has 30 days from the deadline for filing a declaration of intent to file a petition for reassessment. The notice shall be accompanied by a copy of an appraisal data sheet containing the staff value indicators and value recommendation to the Board.

(b) As soon as practical on or before the last day of June, the Chief of the Valuation Division shall notify the state assessee of the values of nonunitary property. This notice shall inform the assessees that they each have 20 days from the date of the mailing of their individual notice to file a declaration of intent to petition for reassessment. The notice will also inform each assessee that if a declaration of intent is timely filed, the assessee has 30 days from the deadline for filing a declaration of intent to file a petition for reassessment.

(c) On or before the last day of June the Chief of the Valuation Division shall transmit notices of allocated assessed unitary values to each assessee. This notice will inform each assessee that it has 10 days from the date of mailing of the notice to petition the Board for reallocation of unitary values and that said petitions will be set for hearing and decisions rendered no later than July 31.

Rule 905. Assessment Electric Generation Facilities

Reference: California Constitution, article XIII, section 19; and Section 721, Revenue and Taxation Code.

An electric generation facility shall be state assessed property for purposes of article XIII, section 19 of the California Constitution if: (1) the facility was constructed pursuant to a certificate of public convenience and necessity issued by the California Public Utilities Commission to the company that presently owns the facility; or, (2) the company owning the facility is a state assessee for reasons other than its ownership of the generation facility or its ownership of pipelines, flumes, canals, ditches, or aqueducts lying within two or more counties.

Rule 1001. Annual Report

Reference: Section 11271, Revenue and Taxation Code.

The report required by Section 11271 of the Revenue and Taxation Code of all persons whose private railroad cars operated upon the railroads in this State at an time during a calendar year shall be filed on or before the thirtieth day of April of the following year.

Rule 1003. Missing Private Railroad Car Count Data

Reference: Section 11293, Revenue and Taxation Code.

In determining the private railroad car count averages required by statute the Board may substitute for missing border crossing information that average length of stay in the state

experienced by private railroad cars of the same class and assessee during the calendar year immediately preceding the year in which the tax is imposed. Border crossing information shall be deemed missing only when it cannot be submitted by the assessee.

CASES

Adams Express Company v. *Ohio State Auditor* (1897) 166 U.S. 185. In taxing properties located within its limits, a state may properly tax things united in use as a whole by reference to the productive use of the entire unit.

American Sheds, Inc. v. County of Los Angeles (1998) 66 Cal.App.4th 384. Certain intangibles, namely the operating permits and business enterprise value of a landfill, were not improperly subsumed in the valuation formula approved by the board. In valuing property under section 110 (e), it may be valued by assuming the existence of intangible assets necessary to put the property to productive use. Thus, the assessor may assume the presence of a liquor license so that a bar's taxable property may be taxed as a bar and not at salvage value, (i.e., a warehouse); though the liquor license cannot be used to "enhance" the value of the property.

Bluefield Water Works and Improvement Company v. *Public Service Commission of The State of West Virginia, et al.* (1922) 262 U.S. 679. In valuing the property of a public utility corporation, the rates must be sufficient to yield a reasonable return on the value of the property at the time it is being used to render service.

California Portland Cement Co. v. *State Board of Equalization* (1967) 67 Cal.2nd 578. When there is insufficient market data available to ascertain the actual market value of the particular type of property, other factors such as replacement costs and income analyses, including the property's net earnings to be capitalized, may be employed.

The Cleveland, Cincinnati, Chicago & St. Louis Railway Company v. *Victor M. Backus* (1893)154 U.S. 439. The true value of a line of railroad is something more than the aggregation of the values of separate parts of it, operated separately; it is the aggregate of those values plus that arising from a connected operation of the whole.

County of Los Angeles v. *County of Los Angeles Assessment Appeals Board* (1993) 13 Cal.App.4th 102. Taxable possessory interests of car rental firms in public airports should be valued on the basis of the physical possession and exclusive use of their leased counters and reserved parking spaces, and not in the entire airport as a business premises. Some rights granted by the firms' agreements to do business at the airports were not possessory interests, but intangibles not subject to property tax.

County of Stanislaus v. *County of Stanislaus Assessment Appeals Board* (1989) 213 Cal.App.3d 1445. The appeals board erred in ruling that the company's entire franchises were nontaxable intangibles. The company's authority to use public rights-of-way is an assessable possessory interest in real property; and while the company's right to engage in the cable television business

is not a part of this interest for assessment purposes, it can be considered in assessing the value of the possessory interest.

Cox Cable Company v. County of San Diego (1986) 185 Cal.App.3d 368. The interests of a cable television distribution company in franchise agreements granting the company the right to use and occupy public rights-of-way for the purpose of distributing its service are subject to property taxation since the company's use constitutes taxable possessory interests. A possessory interest may be the interest of either an easement holder or a mere permittee or licensee.

De Luz Homes, Inc. v. *County of San Diego* (1955) 45 Cal.2d 546 The absence of an actual market for a particular type of property does not mean that it has no value or that it may escape from the mandate of Constitution, article XIII, §1, that all property shall be taxed in proportion to its value, but only that the assessor must then use such pertinent factors as replacement costs and analyses for determining valuation. In valuing a leasehold interest in exempt lands and improvements by the capitalization of income method it is improper, in computing the anticipated net income to be capitalized, to deduct from anticipated gross income the lessee's charges for rent, amortization of his investment, or payments of principal and interest on his mortgage debt. The proper method of valuing a possessory interest in a housing project at a permanent military installation is to deduct from annual anticipated gross income the operating and maintenance expenses and the amount required by the leased to be deposited to a replacement reserve, and to capitalize the difference for the remaining years of the lease at a rate which will allow for risk, interest, and taxes.

Dominguez Energy, L.P. v. County of Los Angeles (1997) 56 Cal.app.4th 839. The performance of environmental cleanup projects in conformity with an environmental protection statute may be treated as a "restriction imposed by government" within the meaning of section 402.1. Upon substantial evidence that the environmental cleanup will not be deferred to the end of the economic life of the property, clean up costs attributable to oil and gas operations should be recognized as nonrecurring capital expenditures within the cash flow. Environmental remediation costs that are likely to occur at abandonment should be treated as abandonment costs in the cash flow

Firestone Tire and Rubber Company v. *County of Monterey* (1990) 223 Cal.App.3rd 382.
Although the cost of pollution cleanup that reduces the fair market value of the property may form the basis for a reduction in the property's valuation under section 110, there was insufficient evidence to establish that the assessor knew or should have known that the plant was contaminated on the date the assessor's valuation of the plant was made.

GTE Sprint Communications Corporation v. *County of Alameda et al* (1994) 26 Cal.App.4th 992
Unit of taxation of public utilities and railroads is properly characterized as the taxation of property as a going concern, not as the taxation of real property or personal property, or even a combination of both. Under the unit taxation method, the Board considers the earnings of the property as a whole, and does not consider, less still assess, the value of any single real or personal asset. The valuation methodology used by the Board to assess tangible property was

invalid, because it did not satisfactorily account for the value of the company's intangible assets. Intangible assets are not subject to property taxation, although their value may be included in the value of otherwise taxable tangible property. The Board erred in assuming that unit valuation, especially when calculated by the capitalized earnings ability method, necessarily taxed only the intangible values as they enhanced the tangible property.

ITT World Communications, Inc. v. *County of Santa Clara* (1980) 101 Cal.App.3d 246.
The State Board of Equalization was free to alter its method of assessing public utility property subject to requirements of fairness and uniformity, and its abandonment of RCNLD as a ceiling was not arbitrary, in excess of discretion, or in violation of the standards prescribed by law. The Board's capitalization of income method of valuation was proper and did not result in an unconstitutional tax on plaintiff's franchise, even though the value arrived at by that method might exceed RCNLD. The Board's prior use of RCNLD did not have the status of a regulation that could be repealed only by pursuing statutory proceedings, and was not a policy that had been consistently acquiesced in by the Legislature and recognized by the courts so as to require legislation to change it.

ITT World Communications, Inc. v. *City and County of San Francisco et al.* (1985) 37 Cal.3d 859. Cal. Const., art. XIII, sec. 19, requiring public utility property to be "subject to taxation to the same extent and in the same manner as other property," does not require utility property to be valued on the same basis as other property, and therefore does not require the application of the valuation rollback provisions in Cal. Const., art. XIII A, sec. 2(a) to unit taxation of public utility property. The valuation rollback provision is limited by its terms to locally assessed real property. Art. XIII, § 19, simply specifies that public utility property be levied on at the same rate as locally assessed property.

Los Angeles SMSA Limited Partnership v. *State Board of Equalization* (1992) 11 Cal.App.4th 768. Market value for assessment purposes is the value of property when put to beneficial or productive use. One of the primary objectives of the system of unit taxation of public utility property is to ascertain and reach with the taxing power the entire real value of such property. It has long been recognized that public utility property cannot be regarded as merely land, buildings and other assets. Rather, its value depends on the interrelation and operation of the entire utility as a unit. Unit taxation is properly characterized not as the taxation of real property or personal property or even a combination of both, but rather as the taxation of property as a going concern.

Madonna v. *County of San Luis Obispo* (1974) 39 C.A.3d 57.
Where there was no evidence that supported the assessment of improvements (a motel, restaurant and shops) based on a capitalized income approach that included enterprise value, and the board rejected two sets of valuation data that were supported, the board acted on speculation and conjecture in determining the assessments. Such action of the board was characterized as arbitrary and capricious, entitling the taxpayer to recovery of attorney's fees.

Michael Todd Company, Inc. v. *County of Los Angeles et al.* (1962) 57 Cal.2nd 684. The market value for assessment purposes is the value of property when put to beneficial use and is not the

residual value remaining when the property is reduced to its constituent elements (e.g., a file negative should be valued as a motion picture, not merely as film). The absence of an "actual market" for a particular type of property does not mean that the property has no value, but only that the assessor must utilize other pertinent factors such as replacement cost and income analysis in making the valuation.

Norfolk and Western Railway Company et al. v. *Missouri State Tax Commission et al.* (1968) 390 U.S. 317. Any formula used in connection with the assessment of state taxes on an interstate enterprise must bear a rational relationship, both on its face and in its application, to property values connected with the taxing state; and a state is not permitted, under the shelter of an imprecise allocation formula, or by ignoring peculiarities of a given enterprise, to project its taxing power plainly beyond its borders.

Roehm v. *County of Orange* (1948) 32 Cal.2nd 280. The California Constitution contains a grant of power to the Legislature to provide for the assessment, levy, and collection of taxes, but it does not grant power to provide for the taxation of intangible assets other than those listed. Liquor licenses are not subject to ad valorem taxation as personal property , since they are not included in the list of intangibles specified.

Shubat v. *Sutter County Assessment Appeals Board* (1993) 13 Cal.App.4th 794. The right of a cable television company to do business, as well as the "enterprise value" of it as a going concern, has a separate value. Thus, the board's method of allocating one-third of the residual value, after assigning amounts to the tangible assets, to the possessory interest and the remainder to other nontaxable intangibles, was reasonable under the circumstances.

South Bay Irrigation District v. *California-American Water Company* (1976) 61 C.A.3d 944. Fair market value, that is, what a willing buyer would pay in cash to a willing seller, is the measure of just compensation in an action in eminent domain brought by a city to condemn for public use a privately owned waterworks system operating as a public utility. It is not improper to attach greater weight to the capitalization of income method of determining market value than to other methods proposed.

Southern California Telephone Company v. *County of Los Angeles* (1941) 45 Cal.App.2d 111. It is the function of a central assessment agency like the State Board of Equalization, to evaluate public utility property as a whole in order to assure the assessment of those values which cling to the entire property as a unit, and in order to assure the assessment of the same type of property at uniform value throughout the state. The very fact of segregation of such assessments from that of other property indicates an intention that the central assessment might be different from the values of the local assessor. In order for discrimination in assessment to occur, there must be two actions relating to different parties, and they must be performed by the same taxing agency.

Southern Pacific Pipe Lines, Inc. v. *State Board of Equalization* (1993) 14 Cal.App.4th 42. While article XIII, section 19 of the Constitution allows for the unit taxation of all public utility property, only those items deemed to constitute a private, intercounty pipeline may be assessed by the Board, including enumerated mechanical parts, fittings, and tanks necessary to the

pipeline's operation. Real property interests, land, and rights-of-way, are excluded from the definition of a pipeline. Similarly, specific facilities, including a products plant, a wharf and marine terminal, engaged in multiple uses were not essential to the operations of intercounty pipeline that terminated there, and thus, were not part of the pipelines which the Board could assess.

GLOSSARY

Abnormal Costs — Amounts recorded in the property accounting records that are greater than what is typically expected in the construction or acquisition of a particular property; for example, costs incurred to correct construction flaws.

Accelerated Depreciation — A method of accruing greater depreciation expense in the early years of a property's life and less in the later years. Two methods of accelerated depreciation are (1) sum of the year's digits and (2) declining balance.

Accumulated Depreciation — (1) The difference between the reproduction or replacement cost of improvements and the market value of the improvements on a given date. (Appraisal concept.)

(2) The amount reserved each year or accumulated to date for the replacement of an asset. (Accounting concept.)

Ad Valorem Tax Component — The part of the total capitalization rate that reflects the property taxes that a hypothetical purchaser would incur on purchase of the subject property. The component is expressed as a relationship between the expected annual property tax expense and value.

Allowance for funds used during construction (AFUDC) — The process of capitalizing the interest expense, or cost of funds, used during the construction of a project. The capitalized interest becomes part of the cost of the project.

Amortization — The process of retiring a debt or recovering a capital investment through scheduled, systematic repayment of principal; a program of periodic contributions to a sinking fund or debt retirement fund.

Annuity — A periodic series of obligatory payments; an annuity can be level, increasing, decreasing, or a combination thereof.

Anticipated Operating Expenses — The amount of future annual expenses anticipated, or expected, from the operation of property by a hypothetical purchaser.

Anticipated Operating Revenue — The amount of future annual revenues anticipated, or expected, from the operation of property by a hypothetical purchaser.

Apportionment to Intrastate Jurisdiction — The process of assigning a portion of a state unit value or state statistic or company statistic to geographical areas within a state, usually tax levying districts or tax-rate areas. Also called intrastate allocation.

Appraisal Unit — The unit of property that is typically bought or sold in the market.

Assessment Ratio — The relationship of assessed value to market value or to some other statutory value such as actual value, true cash value etc.

Band of Investment A technique in which the capitalization rates attributable to components of a capital investment are weighted and combined to derive a weighted-average rate attributable to the total investment. In the context of corporate finance, called the weighted average cost of capital.

Basic Capitalization Rate The rate of return on an investment necessary to attract investors; also known as the return on investment, or yield rate Typically computed by use of the band of investment method. The basic capitalization rate does not include any adjustment for capital recapture or taxes.

Bond Discount A dollar discount to the face value of a bond due to a market interest rate greater than the bond's coupon rate, or stated rate of interest.

Bond Premium A dollar premium to the face value of the bond due to issuing costs or a market interest rate less than the bond's coupon rate, or state rate of interest.

Book Depreciation The total accruals recorded on the books of the property owner property summarizing the systematic and periodic expenses charged toward amortizing a capital investment over its expected limited life.

Book Cost The amount in dollars of an asset as it is carried in the accounting records of a firm. The original cost of an asset.

Book Value Capitalized, or book, cost less accounting depreciation.

Capital Structure The manner in which a business entity is financed; the mix, or relative proportions, of equity and debt used to finance the entity.

Capitalization Process The procedure of converting income into value.

Capitalization Rate Any rate used to convert income into an indicator of value; a ratio that expresses a relationship between income and value.

Cash Equivalent Price of a property expressed in terms of cash, as distinguished from a price expressed, all or in part, in terms other than cash.

Cash Flow The periodic income attributable to a given interest in real property; the cash generated by a business entity.

Certificate of Public Convenience and Necessity A grant of authority from a state or federal regulatory commission authorizing a company to render a public utility service, usually specifying the area and other conditions of service.

Common Carrier An individual, corporation, or entity engaged in transporting persons, goods, or messages for compensation over a regular route, on a certain schedule, or at a published rate, all of which are usually subject to government regulation.

Comparative Sales Approach The technique of valuing properties by comparing them with similar properties that have been sold on a specified date. The comparative sales approach requires the sale of a sufficient number of similar properties within a specified period so that their characteristics and sales prices can be compared. It is based on the principle of substitution, which assumes that buyers would not pay more, and sellers would not accept less, for properties that are similar to, or have comparable utilities, to those that are sold in the same period.

Compound Interest and Annuity Tables Six sets of factors (or coefficients) that embrace the fundamentals of the mathematics of finance. The various factors are here called Present Worth of 1, Present Worth of 1 per Annum, Future Worth of 1, Future Worth of 1 per Annum, Sinking Fund, and Mortgage Repayment.

Cost The expenditure required to develop and construct an improvement or acquire real and personal property.

Debt An obligation to repay a specified amount of money at a specified time. Long-term debt is considered to be a permanent part of the capital used in firm.

Deferred Charges Miscellaneous long term prepayments. Often a catchall account for items that do not fit into any other asset category and are not material enough individually to constitute a separate category.

Deferred Credits Miscellaneous long term liabilities. Often is a catchall account for long term liabilities that do not fit into any other liability category and are not material enough individually to constitute a separate category.

Deferred Income Taxes Accrued income tax credit or accrued income tax charge arising from the use of different accounting methods for financial and income tax reporting. To conform to regulatory requirements, public utilities generally use straight-line depreciation for financial accounting purposes. However, to minimize income tax liability, accelerated depreciation is generally used for income tax reporting. The use of different depreciation methods creates a tax timing difference known as deferred income taxes.

Depreciation A decrease in utility resulting in a loss in property value; the difference between estimated replacement or reproduction cost new as of a given date and market value as of the same date. There are three principal categories of depreciation, described below:

(1) Physical Deterioration. The loss in utility and value due to some physical deterioration in the property; considered curable if the cost to cure it is equal to or less than the value added by curing it.

(2) Functional Obsolescence. The loss in utility and value due to changes in the desirability of the property; attributable to changes in tastes and style or the result of a poor original design. Functional obsolescence is curable if the cost to cure it is equal to or less than the value added by curing it.

(3) External (or Economic) Obsolescence. The loss in utility and value due to an incurable defect caused by external negative influences outside the property itself; results from the immobility of real property.

Easement An interest in real property that conveys the right to use a portion of another's property.

Economic Life The period of time over which improvements to real property contribute to the total property value.

Economic Rent The amount of rental income that could be expected from a property if available for rent on the open market, as indicated by the prevailing rental rates for comparable properties under similar terms and conditions; economic rent is distinguished from contract rent, which is the actual rental income for the subject property as specified in a lease; economic rent is also referred to as market rent.

Embedded Debt Cost The average rate of interest that a company pays for its long-term debt. The amount of total interest paid on long-term debt during the year divided by the face value of the long-term debt outstanding at the year-end. The historical cost of debt.

Equity The ownership interest in a business. The net worth of a business, its total assets minus its total liabilities The amount of money the owners have invested in common and preferred stock plus earnings of the business that have not been paid out as dividends.

Expense The gross dollars periodically paid out for materials or services necessary to production. Operating expenses mean direct and incidental expenses in carrying on the primary business, for example, expenses of an electric utility in producing electric revenues. (Also, see property tax rule 8.)

Fair Return An amount of income authorized by a regulatory agency that is considered sufficient for a utility to attract necessary additional capital and at the same time render adequate service.

Fixed Expenses Expenses of a firm that do not vary in relation to changes in volume of output, for example, interest on borrowed funds, insurance, rent, property taxes or depreciation in some instances.

Form 10-K Report An annual report submitted by corporations to the Securities and Exchange Commission. A new schedule in the 10-K requires certain large corporations to report the replacement cost of their productive capacity, the depreciated replacement cost, and the annual depreciation expense as though it were on a replacement cost basis.

Form R-1 The annual reports of business operation filed with the Surface Transportation Board by class I railroads.

Fractional Method Separately valuing each item of property.

Franchise A grant by a government agency authorizing the sale of product or service in a prescribed geographical area.

Functional Obsolescence A Form of appraisal depreciation. The loss in utility and value due to changes in the desirability of the property; attributable to changes in tastes and style of the result of a poor original design. Functional obsolescence is curable if the cost to cure it is equal to or less than the value added by curing it.

Generally Accepted Accounting Principles (GAAP) Accounting concepts, standards, and procedures adopted and promulgated by the Financial Accounting Standards Board. An audit report contains the auditor's certification of whether or not a firm has followed GAAP in the preparation of its financial statements.

Gross Additions New property added to existing plant or improvements. Betterments added to existing plant or improvements. Usually reported in dollar amounts.

Gross Income Income from the operation of a business or the management of property, customarily stated on an annual basis. Gross income is income to the property from all sources. In an apartment property, for example, the gross income could be the sum of living unit rent, parking space rent, vending machine and laundry facility income. (Also, see property tax rule 8.)

Historical Cost The total cost of a property when it was originally constructed or purchased.

Income Money or other benefits stemming from the ownership of property, generally received on a monthly or annual basis. The word "income" used alone has no specific appraisal significance, but must be qualified – for example, gross income, net operating income, etc.

Income Adjustment Factor An adjustment in the mathematical derivation of the percent good factor that reflects an allowance for the reduction in income from a property as it ages.

Income Approach Any method of converting an income stream or a series of future income payments into an indicator of present value.

Income Influence Method A method of allocating a sale price or stock and debt value of a business to its different segments or subdivisions, according to the contribution of each segment to the total income of the business.

Income Tax Component The part of the total capitalization rate that reflects the income taxes that a hypothetical purchaser would incur upon purchase of the subject property. This component is expressed as a relationship between the expected annual income tax expense and value.

Indicator of Value A estimated of the monetary worth of a specifically identified property (be it a single parcel of land or piece of equipment or an extensive corporate conglomerate) based on consideration of particular characteristics or attributes of the property. Among the most common indicators of value are those derived from cost, income, and comparative sales approaches to value.

Interest Rate The rate of return on debt capital; the price paid for borrowing money.

Interstate Allocation The process of assigning a portion of a unit value or system statistic to a state, assuming that the unit value or system statistic reflects multistate operations.

J Factor An adjustment made to straight-line depreciation in the calculation of the income tax component that reflects the relative benefits or disadvantages of the use of modified accelerated cost recovery system depreciation for determining income tax liability.

Land Reversion The market value of land at the end of the remaining economic life of the assets (other than land) in a limited-life capitalized earnings ability model. This value is discounted to the valuation date using the basic capitalization rate plus a component for ad valorem taxes.

Liabilities Claims held by non-owners on the assets of a business. Liabilities are obligations that a business is obliged to pay before the claims of the owners can be satisfied.

Lien Date	All taxable property (both state and locally assessed) is assessed annually for property tax purposes as of 12:01 a.m. on January 1, which is called the lien date. It is referred to as the lien date because on this date the taxes become a lien against all real property assessed on the secured roll.
Life Study	A survey or study of property lives by property category.
MACRS	The modified accelerated cost recovery system of depreciation allowed by the Internal Revenue Code.
Main Track	Refers to the lines or routes of railroad, whether main line or branch line, as distinguished from yard track, side track, or passing track.
Market Value	Also referred to as full cash value or fair market value. It means the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other and both with knowledge of all the uses and purposes to which the property is adapted and for which it is capable of being used and of the enforceable restrictions upon those uses and purposes.
Net Additions	Gross additions less the retirements; usually reported in dollar amounts.
Net Book Value	The amount, in dollars, of an asset as carried in the accounting records of a business. The original cost of an asset less its accrued depreciation.
Net Operating Income	The actual or anticipated net income that remains after all operating expenses are deducted from effective gross income but before mortgage debt service and book depreciation are deducted.
Noncapitalized Leased Property	Leased property that is not reflected as a liability on a company's balance sheet.
Nonunitary Operations	Income-producing activities of a public utility that are not essential to the provision of its public utility service. Assets owned or used by a public utility that are not essential to the provision of its public utility service are known as nonunitary property."
Nonunitary Property	Property not assessed as part of the unit. (Also, see ‘nonunitary operations.”
Nonutility Operations	Income-producing activities of a public utility not related to its primary public utility function.
Normal Costs	Costs typically expected in the construction or acquisition of a particular property type.

Obsolescence The loss in property value from causes other than physical deterioration. Obsolescence is functional if circumstances internal to the property item render it less desirable; or economic if circumstances external to the property and beyond the control of the property owner render the property less desirable.

Original Cost The cost of the property item to the present owner. Sometimes used as equivalent to historical cost.

Percent Good The complement of depreciation; if a property is 20 percent depreciated, its percent good is 80 percent. Percent good refers to the portion of benefits remaining in an asset compared to the total benefits when new.

Possessory Interests Interests in real property that exist as a result of (1) a possession of real property that is independent, durable and exclusive of rights held by others in the real property, and that provides a private benefit to the possessor, except when coupled with the ownership of a fee simple of life estate in the real property in the same person; or (2) A right to the possession of real property, or a claim to a right to the possession of real property, that is independent, durable and exclusive of rights held by others in the real property, and that provides a private benefit to the possessor, except when coupled with the ownership of a fee simple or life estate in the real property in the same person; or (3) Taxable improvements on tax-exempt land.

Present Value (PV) The value of a future payment or series of future payments discounted to the valuation date or some other specified date.

Pre-tax Cash Flow Cash flow plus payment for income taxes. When applied to "cash flow", the term "before-tax" refers only to income taxes.

R3 Survivor Curve One of the asset retirement curves developed and published by the Engineering Department at Iowa State University.

Rate Base The dollar amount established by a regulatory agency on which a return is allowed.

Rate of Capitalization A ratio of income to value. There are many types of capitalization rates depending on the elements included the rate, for example, interest; investment, or capital; recapture, ad valorem taxes; and income taxes.

Rate of Return A general term used in several ways. May refer to the yield to an investor, either on equity investment or total property value. May refer to the ratio of net operating income, before-tax cash flow, or some other level of income to the total property value, the initial equity or total investment, or the average equity or total investment during a given period.

Recapture	The return of invested capital. Capital may be returned gradually in periodic income, all or in part in resale of the property, or both. Different capitalization techniques are often distinguished by different methods of capital recapture.
Remaining Economic Life	The estimated period during which the improvements will continue to contribute to a property's value.
Replacement Cost	The cost required to replace an existing property with a property of equivalent utility.
Reproduction Cost	The cost required to reproduce an exact replica of an existing property.
Return on Equity	The ratio calculated as (typically annual) earnings on common equity divided by the value of the interest in common equity.
Revenue	The gross dollars received for the product or service provided. Operating revenue means revenue from the primary operations of the business, for example., electric revenues of an electric utility.
Reversion	A lump sum monetary benefit from a property that an investor receives or expects to receive at the termination of an investment.
Risk	Uncertainty about the outcome of future events; uncertainty about the future profitability of investments or projects; the possibility of not receiving the projected income.
Single Life Method	In the individual, or single life method, the percent good is simply a relationship between the present worth of an income for the probable remaining life expectancy and the present worth of an income for the total life expectancy. The single life method assumes that the best estimate of the future life expectancy of the survivors of a group is the average of the group.
Straight-line Depreciation	In accounting, of the practice of charging equal annual amounts of book depreciation expense; in appraisal, an assumed equal annual amount of loss in value to the property reflected as an allowance for depreciation in the capitalization rate.
Summation Method of Valuation	The combining of fractional valuations into one value; for example, the addition of the estimated value of the structure to the estimated value of the land to produce an estimate of the total property value.
System	An integrated operation constituted by separate units that may be related operating entities themselves or individual property elements, such as machinery, buildings, land, and other property, used in the production of goods and services.

Taxable Possessory Interest	A private right to possession and use of publicly owned property for a period of time less than perpetuity.
Total Capitalization Rate	A capitalization rate that converts the income to be capitalized into a capitalized value. The rate includes the investors' perception of both return on and return of (i.e., capital recapture) of the investment and components for ad valorem property taxes and income taxes.
Trending Factor	An index number expressed in decimal form that estimates the change in some variable—cost, for example—over a time interval. A trending factor is multiplied by historical cost to estimate reproduction or replacement cost new.
Uniform System of Accounts	A prescribed method of accounting adopted by a state regulatory agency, such as a Public Utilities Commission; or by a federal regulatory agency, such as the Civil Aeronautics Board, the Federal Communications Commission, the Federal Energy Regulatory Commission, or the Interstate Commerce Commission.
Unit Method of Valuation	The technique of valuing a group of property items as "one thing."
Unitary Operations	Income-producing activities of public utility essential to the provision of its public utility service. All property owned or used by a public utility and essential to the provision of its public utility service is known as "unitary property".
Variable Expenses	Expenses of a business that vary with changes in volume of output, such as outlays for fuel in the generation of electric power.
Working Cash	The amount of cash, or cash balance, required for payment of expenses that are due before the revenue is collected. Necessary for most firms because of the unavoidable timing difference between cash receipts and disbursements.
WSATA	Western States Association of Tax Administrators. WSATA is an association of tax administrators from twelve western states – Alaska, Arizona, California, Colorado, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington and Wyoming. Primary goals of the association are to facilitate dialogue among tax administrators, industry representatives, and academicians; and to promote research concerning issues affecting state assessment.
Yield Rate	See basic capitalization rate.

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